S. Hrg. 103–670

A REVIEW OF ARMS EXPORT LICENSING

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE, AND CIVIL SERVICE

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

JUNE 15, 1994

Printed for the use of the Committee on Governmental Affairs

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A REVIEW OF ARMS EXPORT LICENSING

WEDNESDAY, JUNE 15, 1994

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE,
AND CIVIL SERVICE, COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:36 a.m., in room SD–342, Dirksen Senate Office Building, Hon. David Pryor, Chairman of the Subcommittee, presiding.

Present: Senator Pryor.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Good morning, ladies and gentlemen. We welcome all of you this morning to this hearing.

Today, we are going to examine a small part of a multi-billion dollar industry, which is the global arms trade. Today, the United States is currently the leading exporter of arms. We exported roughly $33 billion in arms last year, which was triple the $11 billion exported in 1991. In fact, the United States accounted for 56 percent of the conventional arms exports to the Third World in 1992.

Most of these exports are made on a government-to-government basis. They are handled by the Pentagon through a program called Foreign Military Sales. We refer to this as FMS.

However, a very important part of the U.S. arms exports leave the country under commercial licenses, approved either by the Department of State or the Department of Commerce. The State Department receives over 50,000 applications a year to export U.S. munitions and weapons.

The purpose of this morning's hearing is to revisit an issue that I first looked at in 1987. That was 7 years ago, it is hard to believe. In fact, the very first hearing I held as Chairman of this Subcommittee was an investigation into the arms licensing function at the Department of State.

At that particular time, we discovered that the State Department office responsible for this duty, the Office of Munitions Control, OMC, did not even check to see if a person applying for an arms export license was a criminal. OMC witnesses stated they did not check to see if the potential arms exporter had been convicted of treason or not or had committed some other felony.

Needless to say, I found this to be an outrage. Not only did OMC not check to see if convicted criminals were obtaining licenses to export U.S. munitions, but furthermore, incredibly, OMC officials

testified that they did not keep a watchlist of suspect persons or companies.

In addition, OMC only conducted 40 or 50 end-use checks a year to determine if the exported munitions actually went to the authorized user and were not diverted to U.S. adversaries. This lack of comprehensive watchlist severely limited licensing officers' ability to spot questionable applications and order an end-use check on a particular export.

At that time, we were successful in amending the Arms Export Control Act to address some of these problems. The legislative changes gave the Department of State new authority to deny licenses to criminals. In addition, the State Department now has a clear authority to maintain a comprehensive watchlist of persons who had either been convicted of a felony or about whom the State Department has some derogatory information.

Today, we will review the arms licensing operation at the State Department to see if the problems identified in 1987 have been corrected. The OMC has been now renamed. It is now called the Center for Defense Trade. However, according to the General Accounting Office, which is releasing its report this morning, some of the same weaknesses, as we will see, still exist. There are massive gaps in the watchlist which still permit the wrong persons to obtain an arms license.

For example, the General Accounting Office found that the company convicted in March 1992 of violating the Arms Export Control Act for exporting munitions to Iran received three licenses from the Department of State between July and December of that same year. This is unacceptable. It is inexcusable. Unfortunately, this is not an isolated example.

The GAO further found that the watchlists of State and Commerce, which approve licenses for dual-use exports, were missing hundreds of names of persons who should either be denied an export license or whose involvement in the export should involve a great deal of concern to U.S. officials. Because of these flawed watchlists, State and Commerce today have issued at least 230 licenses to companies and individuals without the licensing officer knowing about the critical and sometimes negative information.

Furthermore, even when some companies are put on the watchlist, because of internal flaws in the system, GAO finds that State and Commerce issued over 800 licenses to parties who were on their watchlists without any consideration of the derogatory information on the lists. Since the State Department is processing over 50,000 license applications a year, the lack of an effective watchlist prevents the U.S. Government from keeping the wrong characters from receiving arms licenses.

Finally, when our staff reviewed information on some 1,600 licenses to eight countries in Latin America, they found that in only 21 cases did the State Department perform an end-use check to verify that the exported arms were not going to be diverted.

In addition, in reviewing the State Department's own publications, it is very apparent that the highest priority at State is the quick processing of arms export licenses. I will include in the hear-

ing record a majority staff report prepared by the Subcommittee staff regarding this particular concern.[1]

PREPARED STATEMENT OF SENATOR PRYOR

Today, we will examine one small part of a multi-billion dollar industry, the global arms trade. The U.S. is currently the leading exporter of arms and, in fact, the U.S. accounted for 56 percent of the conventional arms exports to the Third World in 1992. Most of these exports are made on a government to government basis and are handled by the Pentagon through a program called Foreign Military Sales. However, an important part of the U.S. arms exports leave the country under commercial licenses approved either by the Department of State or Commerce. The State Department receives over 50,000 applications a year to export U.S. munitions.

The purpose of today's hearing is to revisit an issue I first looked at in 1987. In fact, the very first hearing I held as Chairman of this Subcommittee was an investigation into the arms licensing function at the Department of State. At that time, I discovered that the State Department office responsible for this duty, the Office of Munitions Control or OMC, did not check to see if the person applying for the arms export license was a criminal. OMC witnesses stated that they did not check to see if the potential arms exporter had been convicted of treason or had committed some other felony.

Needless to say, I found this to be an outrage. Not only did OMC not check to see if convicted criminals were obtaining licenses to export U.S. munitions, but furthermore, OMC officials testified that they did not keep a watchlist of suspect persons. In addition, OMC only conducted 40 or 50 end-use checks a year to determine if the exported munitions actually went to the authorized user and were not diverted to U.S. adversaries. This lack of a comprehensive watchlist severely limited licensing officers ability to spot questionable applications and order an end-use check on a particular export.

I was successful in amending the Arms Export Control Act to address some of these problems. The legislative changes gave the Department of State new authority to deny arms licenses to criminals. In addition, State Department now has clear authority to maintain a comprehensive watchlist of persons who had either been convicted of a felony or about whom State has some derogatory information.

Today we will review the arms licensing operation at the State Department to see if the problems identified in 1987 have been corrected. The OMC has been renamed and the new office is called the Center for Defense Trade. However, according to the General Accounting Office, which is releasing its report today, some of the same weaknesses still exist. There are massive gaps in the watchlist which still permit the wrong persons to obtain an arms license. For example, GAO found that a company convicted in March 1992 of violating the Arms Export Control Act for exporting munitions to Iran, received three licenses from the Department of State between July and December of that same year. This is unacceptable. Unfortunately, this is not an isolated example.

The GAO found that the watchlists of State and Commerce, which approves licenses for dual-use exports, were missing hundreds of names of persons who should either be denied an export license, or whose involvement in the export should cause a great deal of concern to U.S. officials. Because of these flawed watchlists, State and Commerce issued 230 licenses to companies without the licensing officer knowing about the critical information. Furthermore, even when some companies are put on the watchlists, because of internal flaws in the systems, GAO found that State and Commerce issued over 800 licenses to parties who were on their watchlists without any consideration of the derogatory information on the lists. Since the State Department is processing over 50,000 license applications a year, the lack of an effective watchlist prevents the U.S. government from keeping the wrong characters from receiving arms licenses. Finally, when my staff reviewed information on 1,600 licenses to eight countries in Latin America, they found that in only *21 cases* did the State Department perform an end-use check to verify that the exported arms were not going to be diverted. In addition, in reviewing the Statue Department's own publications, it is apparent that the highest priority at State is the quick processing of arms export licenses. I will include in the hearing record a majority staff report prepared by the Subcommittee staff.

I am disappointed in these findings. We will listen first to the GAO and then we will hear from both the Department of States and Commerce on how we can correct these shortcomings in our licensing systems.

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[1] The majority staff report appears on pages 35–48.

Senator PRYOR. I am very disappointed today at the findings of the GAO. It is still far too easy to get a license to export arms. Less than five percent of the persons who apply for an arms license are denied one. We still are not fully checking to see if only legitimate companies are obtaining these licenses.

We will listen first this morning to the General Accounting Office, and then we will hear from both the Departments of State and Commerce on how we might correct these shortcomings in our licensing system.

First this morning we would call as our first witness Mr. Jim Wiggins. Mr. Wiggins is the Associate Director, Acquisition Policy, Technology and Competitiveness Group, National Security and International Affairs Division of the General Accounting Office. I believe Mr. Wiggins has other colleagues with him that he may want to introduce at the appropriate time.

TESTIMONY OF JAMES F. WIGGINS,[1] ASSOCIATE DIRECTOR, ACQUISITION POLICY, TECHNOLOGY AND COMPETITIVENESS GROUP, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY DAVI M. D'AGOSTINO

Mr. WIGGINS. Thank you, Mr. Chairman. It is a pleasure to be here this morning to discuss our review of export license screening procedures at the Departments of State and Commerce. We believe that effective export license screening is essential, because it provides the first line of defense against parties seeking to misuse or divert exported U.S. weapons, munitions, and sensitive dual-use items and technology.

With me this morning, Mr. Chairman, is Ms. Davi D'Agostino, the assistant director for our review. Performing this review were evaluators John Ting and David Trimble.

Mr. Chairman, with your permission, I have a rather lengthy statement that I would like to submit for the record and briefly summarize the contents of that statement.

Senator PRYOR. We would appreciate that.

Mr. WIGGINS. Today, I have some good news and not-so-good news to report. First, the good news. In 1987, we reported and testified before you that the Department of State was not routinely screening license applications to identify ineligible or undesirable parties.

Since that time, State has established automated license application screening procedures to help identify parties needing closer scrutiny. The Department of Commerce has had automated license screening procedures since 1984. Compared to 1987, there has been an overall improvement in export licensing screening.

The not-so-good news is that our most recent work shows that significant weaknesses still exist in screening export license applications at both the Departments of State and Commerce. As you know, Mr. Chairman, the Department of State is responsible for reviewing and approving export licenses for weapons and munitions. The Department of Commerce licenses dual-use items such as la-

[1] The prepared statement of Mr. Wiggins and the report of the General Accounting Office appears on pages 49 and 65.

sers, calibrating equipment, guidance systems, supercomputers, and other technologies that can be used for both military and non-military purposes.

Export application screening is intended to identify and deny a license to those parties that are known or suspected diverters or proliferators. To screen license applications, both agencies have developed watchlists of real and potential bad guys. These include persons and companies that have either been (1) convicted of export control violations; (2) identified by intelligence or Department officials as known or suspected violators, diverters, or proliferators; or (3) have been debarred from export activities in the U.S.

The not-so-good news is reflected in our findings to six key questions addressed in our review. I will briefly go over each of these questions.

The first question, are the Departments of Commerce and State maintaining complete and current watchlists to screen applications? Mr. Chairman, the answer to this question is no. Of the 2,800 names that we checked, we found that each agency had failed to include about 27 percent of the names on their watchlist.

For example, we examined 92 names listed by the Department of Justice as fugitives indicted for or convicted of significant export control violations. At the time we checked, Commerce had not placed 69 of these names on its list, and State had not placed 47 of these names on its watchlist.

In some cases, licenses were issued to these parties. As shown in Attachment 2 in the prepared text, of the names we checked, we found a total of 224 licenses were issued to parties that should have been but were not on the watchlist.

Senator PRYOR. This is on your first chart?

Mr. WIGGINS. Yes, Mr. Chairman.

Senator PRYOR. What is that total of 224 again?

Mr. WIGGINS. That is the number of licenses that were issued to parties that were not on the watchlists.

Senator PRYOR. This is in a three-year period, is this correct?

Mr. WIGGINS. Yes, Mr. Chairman. That is from 1990 through August 1993.

Senator PRYOR. And this is a sampling of a certain number of samples that you took?

Mr. WIGGINS. Yes, Mr. Chairman.

Senator PRYOR. You found 224 who were granted a license?

Mr. WIGGINS. Right. We sampled about 2,800.

In one case, a State Department Blue Lantern review found that a company, Company K on the chart, was selling F–16 parts without authorization. However, the name of this company was never placed on State's watchlist. In May 1993, State approved an export license involving this company.

The second question, do State and Commerce identify all export license applications that involve watchlist parties? The answer is no. We found numerous license applications were processed and approved without being caught by the screening systems.

As shown in Attachment 3 and on the chart, on the right, we identified 934 licenses with watchlist names that slipped through State's and Commerce's screening systems without being reviewed. Eight-hundred-and-forty-seven of these were approved.

The chart shows, for example, that Commerce approved 18 licenses to watchlist parties of nuclear proliferation concern without screening them. Further, Commerce approved three licenses to watchlist parties of missile technology control concern without screening them.

In one case, not in our sample, and as you note in your opening statement, a company convicted of illegally selling aircraft parts to Iran had been debarred by State from future export license and placed on State's watchlist. Nonetheless, in 1992, State issued four licenses involving this company without the applications being caught by its screening system.

The third question, do State and Commerce effectively share information on their watchlists? The answer, again, is no. They do not routinely share their lists, and consequently, each agency has issued licenses involving parties on the other's list. We compared State's and Commerce's watchlists and found thousands of entries on each of the lists that were relevant to, but not included on, the other agency's watchlist. These entries represent negative or derogatory information on companies and individuals that State and Commerce are not using in their licensing reviews.

At this point, Mr. Chairman, I want to emphasize that we are not saying that State and Commerce issued licenses that should not have been issued. What we are saying is that these licenses were issued without considering negative or derogatory information regarding these parties. Had the information been considered, the licensing decisions may or may not have been different.

The fourth question, is Commerce making the most effective use of intelligence information in screening export applications? The answer, again, is no. Commerce does not use intelligence information from its watchlist to deny a license unless it can find corroborating information from other sources.

For the period 1990 to August 1993, we found 49 licenses that had names on the Commerce watchlist based on intelligence information that were approved after prelicensing checks failed to corroborate the negative information.

The fifth question, is State monitoring agreements involving the manufacture and distribution of defense articles outside the United States? The answer is no. State neither monitors nor routinely collects these agreements or the annual sales reports required in the regulations.

Finally, Mr. Chairman does State verify that only U.S. persons are granted munitions export licenses? The answer is no. State relies on applicants' self-certification that they are U.S. persons and does not routinely verify these claims with documentation.

Mr. Chairman, our report that we are releasing today contains recommendations for addressing the licensing screening weaknesses we found. Essentially, our recommendations seek to ensure that State's and Commerce's watchlist information is complete and current; their computer systems and procedures are capable of identifying all export applications with watchlist parties; and watchlist information is shared on a routine basis.

Mr. Chairman, that concludes my statement. I will be pleased to answer any questions you may have.

Senator PRYOR. Mr. Wiggins, I want to thank you, and I want to applaud you and your staff for bringing to us today this very exceptional report. It is a report which once again underlines how lax this process is as it relates to securing an arms sales license for overseas.

I am going back just a few years, but subsequent to our hearings in 1987, 3 years after those hearings, I have copies of the *Defense Trade News* dated September 1990 and March 1990. It is amazing to me to see that it seems as it was in 1990 and certainly in 1987, after we had our first hearings, that the thrust of licensing was not monitoring, not seeing who was going to get a license, but actually to see how quickly a license could be issued.

For example, in the *Defense Trade News*, which is an official U.S. Department of State document, on page four in this particular publication, the bottom line, fast license, average license now issued in 13 days. So it seems what the thrust was at that particular time was to see how quickly a license could be issued.

In the article itself, it says, "Fast License. From the industry perspective, the best measure of DTC's performance is undoubtedly the responsiveness of the licensing process. Average licensing times would thus seem to provide a good gauge of the performance of the Controls Office to date." This is from a publication of our own State Department.

In the March 1990 issue of *Defense Trade News*, it says "Controls Office Expanding. Faster, More Responsive Licensing the Goal." Then it says, "11,000-Plus Licenses Issued in Seven Weeks", which I think perhaps at that particular time was an all-time record. They take great pride in the number of licenses that are awarded and I just think it is an amazing revelation to see that this still seems to be the prevailing sentiment there and the prevailing thrust of what this particular function of Government is all about.

Your investigation found that both of the watchlists in State and Commerce were missing about 27 percent of the names that should have been on them. Why did this occur?

Mr. WIGGINS. First of all, I think part of the root cause is something you just touched on, Mr. Chairman, is that there are competing priorities going on in both the State Department and the Department of Commerce. One is the emphasis on the quick turnaround of licenses.

I guess the more direct answer to why these gaps occurred is that it is a procedural problem and that they haven't established the procedures, or assigned the responsibilities to the individuals to make sure that these lists are current and up to date. I am not sure if that is a reflection of the relative management priorities at those agencies or not, but it certainly seems to be a procedural problem that needs to be a focus of top management attention.

Senator PRYOR. When you asked the State Department or the Commerce Department, their agents and representatives, about these so-called gaps and problems, what was their reaction, and do you sense that they are going about the business of fixing what is wrong?

Mr. WIGGINS. In the case of the State Department, they recognize the extent of the problems. They have made some great strides in improving, and they recognize they have a long way to go and

seem like they are very interested in taking whatever corrective actions need to be taken.

They are also quick to point out that part of it is a resource problem. Again, that gets back to relative management priorities.

In the case of the Commerce Department, while they have greater resources to devote to this, they are faced with competing demands and interests in the quick and timely approval of these license applications. They recognize some of our findings and have requested, and we are providing, additional details regarding the rest of our findings. I think once they receive and analyze those, they may be in a position to provide more response.

Senator PRYOR. Speaking of resources, what does it cost to get a license to sell arms overseas?

Mr. WIGGINS. I am not sure of the exact cost. Do you have any idea?

Senator PRYOR. I know in 1987, I think the average cost per license was somewhere around $50. I think I am correct in saying that. I am not certain, but I think now that has been raised to about $200 per license. I see some affirmative nodding of heads by your colleagues sitting behind you there, Mr. Wiggins.

This might be a suggestion on deficit reduction, if we could increase substantially those licenses. I think I will bring that up with Senator Moynihan and others later on.

Tell me, if you would, about the 800 licenses involving persons who were on watchlists but the screening system failed to highlight this for the licensing officer. We sold 800 during this period that we know of, probably a lot more, licenses to these individuals that the screening system did not pick up. Now why did they not pick them up?

Mr. WIGGINS. Let me take each agency separately. First of all, at the State Department, while they have instituted an automated system, it is still very primitive and still relies on a lot of manual name matching. So they have a long way to go in terms of having the updated and more technologically-advanced capabilities to do the matching that is needed for lists of this magnitude.

Relying on the manual techniques with the limited resources that the State Department says are available to do these checks is probably the primary problem faced by the Department of State.

Commerce, on the other hand, has a more sophisticated computer matching system. However, maybe as part of its sophistication, at least initially, they loaded in a lot of duplicate names, multiple names, for the same companies and parties. The proliferation of these multiple names for the same parties has resulted in a lot of these matches not occurring.

For example, if there are five or six names or variations of a name for a particular company or party, when the application comes in, the watchlist name may not flag the exact name that is on the application because there are multiple names.

The Department of Commerce tells us that they are trying to reduce these multiple names and have made some progress and recognize there is a lot more they have to do.

Senator PRYOR. The day before yesterday, I went to the Safeway. I wrote a check out at the counter and handed it to the checkout person. He put my check into a little machine. I said, I am curious.

Does that show when I wrote my last check to you? He said, yes. They have a total computerized identification of that particular check.

Why can't we do something like that in the licensing process? Don't we have that computer capability?

Mr. WIGGINS. It is certainly technologically feasible, and like you say, you see it in the commercial sector. I am sure it is feasible and something that could be within the means of agencies to do.

Senator PRYOR. Would you like to add to this? I thought I saw you making a suggestion to Mr. Wiggins.

Ms. D'AGOSTINO. One of the causes, at least, that we have identified of the problem at Commerce is that there are a lot of folks authorized to enter watchlist parties into the system, and they assign these parties identification numbers. They are assigning the same parties more than one number, and some of those numbers don't have the flags on them that make the license stick out.

I am not sure that you would want to stop having a number of people entering watchlist parties into the data base, but I think there is a way to get a program together to eliminate the multiple I.D. numbers or to flag all I.D. numbers assigned to a watchlist party.

Senator PRYOR. In 1987, in February when we were holding the hearing for the first time—by the way, Senator Mitchell, our majority leader, was a member of this Committee at that time after I had asked some questions about who was qualifying today to receive these export licenses, Senator Mitchell asked this question, on February 20, 1987.

Senator MITCHELL. "Well, let me see." Now this is addressed to Mr. Robinson, who was the Director of OMC at that time. "Well, let me see. Well, let me, as we often do, make the point by exaggeration. Suppose a person is convicted of treason against the United States. Under the law now, that person would apply to file a registration with your Department and you have no basis to turn them down as an exporter of arms. Isn't that what you just said?"

Mr. Robinson responds. "That is what I said. And I would further say that if I did turn him down and he took me to court, I would get beat." That is the end of that particular little exchange there.

If there is a person—I am asking the question 7 years later in another way—if there is a person who has been convicted of treason and that person applies for a license, is that person possibly going to get that license? Is that person going to fall between the cracks? Is the watchlist going to be absent his name? What do you see there as the possibility of that person convicted of treason getting a license?

Mr. WIGGINS. Yes, it is possible. First of all, as we testified, it is possible that the agency may not pick the name up on a watchlist, whether that would come from the Department of Justice or whoever that source of information for the conviction of treason would come from. So it is possible that it would not get picked up on a watchlist.

Second, as we testified, even if it does get picked up on a watchlist, it is possible that it may not be matched with the application.

Third, if it is reviewed and the sources from intelligence data and the pre- or post-licensing checks cannot corroborate that this is a treasonous person, or whatever the derogatory information is, in the case of Commerce, they may be unwilling to identify that its information is from intelligence sources and could approve the license.

Senator PRYOR. We have already discussed, or I think you alluded in your opening statement, to the Department of State issuing three licenses recently involving a company convicted of illegally selling aircraft parts to Iran, even though the State Department had debarred the company from future export licenses and had listed the company on its watchlist.

How can this company be convicted of selling U.S. aircraft parts to Iran, get placed on the watchlist at the State Department, and then turn around and apply for and receive three more licenses? Is this an exception to the rule or what is going on here?

Mr. WIGGINS. Mr. Chairman, I don't know for sure whether it is an exception to the rule or not. It is clearly the type of thing that can happen when you are relying on unsophisticated, manual systems that the State Department is using, faced with its resource constraints and also time pressures to approve applications.

I hope this is an exception. I hope there is not a lot of this happening, but I just don't know.

Senator PRYOR. You picked this up basically on a random check?

Mr. WIGGINS. Yes.

Senator PRYOR. Do you feel that the State Department is concerned about this type of thing happening? Are they monitoring these particular sales sufficiently? It doesn't seem that they are to me.

Mr. WIGGINS. I guess the proof of the pudding, Mr. Chairman, will be their response to these things and whether or not this type of thing—getting the attention it is getting—will bring to bear management's attention, the resources, and the upgrading of its capabilities to make sure these things don't happen again.

As we have talked, some of these problems have been in existence for a number of years now, and we have seen some progress but there is a long way to go.

Senator PRYOR. I just think in the last 7 years, since we had our first hearing, all the sales that have taken place, if we approved 50,000 or 60,000 separate licenses for arms sales overseas since that time, and we multiply that by seven, we are looking at the proliferation of all kind of arms throughout the world.

The thing that we dwelled on in 1987, in addition to who might be eligible to receive a license, was what was happening with end-use checks, specifically, how efficient and how much priority were we putting on end-use checks to see actually where these arms were ending up.

Would you address the issue of end-use checks to see what we are doing? Have we made any progress there?

Mr. WIGGINS. Davi, could you address that?

Ms. D'AGOSTINO. I think recent reviews by the State Department IG's office have pointed out weaknesses, and then I think follow-on reviews have shown some improvement in State's Blue Lantern program.

Senator PRYOR. For the record, what is the Blue Lantern program?

Ms. D'AGOSTINO. That is the State Department's program to do pre- and post-license checks on end users.

Senator PRYOR. And the Commerce Department has a similar in-house program?

Ms. D'AGOSTINO. Right.

Senator PRYOR. And the name of that program is what?

Ms. D'AGOSTINO. I think they just call it pre-licensing checks, (PLCs), and post-shipment checks.

Senator PRYOR. Thank you.

Ms. D'AGOSTINO. In any case, there are indications that they are certainly doing better than they were in 1987, but I think the indications from the State Department IG's work shows that they have a long way to go. I think they are trying to make improvements.

Mr. WIGGINS. I might add, Mr. Chairman, I think what you stated is a scary thought indeed. With the end of the Cold War and the emphasis on promoting exports that we have recently decontrolled a lot of items. Those are items that, I guess, a determination has been made would be at lower risk of proliferation or diversion for misuse.

The items that remain on a list would be the more serious items, the ones that would be more dangerous and of more concern. So I think it is as important or more important today that the priority be placed on making sure that these items are properly screened. Given the severity and the potential severity of the outcome of these types of items getting in the wrong hands, it is certainly worth the extra time that may be required to better assure that they don't.

Senator PRYOR. I believe that you listed in your report, though, that it was a material weakness, especially at the State Department, the lack of end-use checks. Is that correct?

Mr. WIGGINS. Yes.

Senator PRYOR. As recently as this morning, in the *Washington Post*, I will call your attention to June 15, "Rwanda's Arms Suppliers". I think that this editorial is right on point as to what we are talking about. It relates to, very directly, the end use issue.

I am going to have placed in the record at the appropriate place this particular editorial, which appeared this morning in the *Washington Post.*[1]

Senator PRYOR. Is the emphasis today at the State Department and at the Commerce Department to grant licenses so that we can sell weapons overseas? Is that the emphasis? Is that the priority? Or is it to monitor and make certain that those who desire to sell are the right types of individuals and the right types of companies to make these transactions? I wonder if you would address that. Where is the priority?

Mr. WIGGINS. I think you have competing priorities. I think if you look at the evidence in terms of management priorities and resources they are devoting to catching these things, it may lead you to conclude that the greater priority may be in promoting trade and approving these licenses.

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[1] See page 161.

I think, as in a lot of organizations, you often have these competing priorities. I think when you look at the resources going to the control side of the house and the types of things that are being done and not being done to exercise the controls, it certainly is an indication of where the priorities are with that particular agency, at least at the top management level.

Senator PRYOR. Last fall, as I understand it—I believe it was last fall—there was an arms bazaar in Singapore and our country sent an aircraft carrier to that particular arms bazaar. I assume it was loaded down with all kinds of goodies that would be displayed there and tempting all of the countries there who were present in Singapore to make purchases.

It does appear to me that this has gotten to be a very major business, and that not only the State Department but also Commerce Department are emphasizing sales and granting licenses and doing very poorly on background checks on who should actually have these licenses.

The second area of concern that I have is the cooperation, or the lack of cooperation, between the State Department and Commerce Department in, say, comparing their watchlists or comparing information about individuals who are applying through each Department for a license. I wonder if you might address that.

Mr. WIGGINS. I think the lack of cooperation has been a fairly longstanding issue. I think it has been recognized in the past. We understand that they have met a couple of times to try to work closer in terms of integrating their watchlists, but nothing has really come of those meetings that I am aware of.

There is certainly no reason why they shouldn't cooperate more, particularly in terms of the watchlists. If you look at the types of things that are on Commerce's watchlist that don't show up on State's watchlist, it is mostly data generated by the Department of Commerce itself. So I think there is certainly a lot more opportunity to cooperate closely and make sure that their watchlists are more compatible.

Senator PRYOR. There seems to me like a total lack of caring between the two Departments as to a desire to share this information. Once again, is that indicative of the emphasis or lack of emphasis on checking out these people who want to become arms exporters?

Mr. WIGGINS. Again, I think it is a reflection of the relative priorities of the agencies. It may be even a deeper cultural problem within the agency. The Department of Commerce, as you know, is generally in the business of promoting business and commerce. The Department of State may be a little more strict in terms of its approach to controls.

So given the conflicting missions of those two offices and agencies, that may be a part of the root cause that we don't have the cooperation that is, indeed, needed.

Senator PRYOR. In your report, Mr. Wiggins, you brought out another concern that I think should really command a lot of our attention, and that is your allegation that we are seeing very little indication that the Department of State and the Department of Commerce are even researching to see whether a person is a U.S. citizen before they grant a license. What is that issue?

Mr. WIGGINS. This is more an issue with the Department of State.

Ms. D'AGOSTINO. You are dealing with U.S. person status. The State Department is the only agency of the two that is required to screen for that. Basically, the issue that we have with State is that they don't require documentary proof, at least the first time an applicant comes in with a license application, of U.S. person status. They rely on a self-certification, and although they say they have made some checks, they have done these by telephone and really haven't gotten validated, documentary proof of U.S. person status.

Senator PRYOR. Of equal concern, and also of equal emphasis, I think, in your report, you indicate that the State Department is not collecting nor reviewing the annual sales reports that the U.S. arms companies are required to submit. They are required to submit these sales reports, is that correct?

Mr. WIGGINS. Yes, that is correct.

Senator PRYOR. What happens to them?

Mr. WIGGINS. Our review is that the whole operation for collecting and reviewing those agreements is in disarray. It is not clear who is responsible for doing this, and in a lot of cases, we see that these things are not being reviewed.

Senator PRYOR. Are they just warehoused?

Mr. WIGGINS. We just find them stacked and there doesn't seem to be an orderly process for reviewing or management emphasis on ensuring that they are being reviewed.

Senator PRYOR. Is there anyone in charge at the State Department office that police the licenses and grant the licenses, is there any one person in this division in charge of reviewing sales reports?

Ms. D'AGOSTINO. No. This one, again, would only apply at the State Department for purposes of our work, but no, there wasn't anyone responsible for making sure that these sales reports come in and get examined.

Senator PRYOR. It would appear to me, as a layman, that it would be necessary to not only review in detail but to understand specifically the content of the sales reports, especially as you are doing end-use checks as to which arms ultimately may be winding up in Rwanda or wherever else in the world.

If these sales reports are not being checked, I see a massive hole and a major problem therein. It seems like what they are concerned with doing, rather than reading the reports and studying them and following up on the end-use efforts, is simply to make certain that they stamp and grant as many licenses as possible as quickly as they can.

How many each year, for example? Is it 50,000 a year that we grant?

Mr. WIGGINS. I think it is close to 40,000 this year.

Senator PRYOR. In the State Department or Commerce?

Ms. D'AGOSTINO. State.

Mr. WIGGINS. State.

Senator PRYOR. In State, and how many in Commerce?

Ms. D'AGOSTINO. I think last year was about 20,000.

Senator PRYOR. Twenty thousand or so? How many are rejected?

Ms. D'AGOSTINO. We don't have the statistics for the Commerce Department, but I was told that at State, it was about five percent denials.

Senator PRYOR. Five percent denials?

Ms. D'AGOSTINO. But in addition to that would be licenses returned without action, which has the same effect as a denial, or those on which provisos or limitations or restrictions might be placed—approvals but with restrictions.

Senator PRYOR. Do you know of a case where either of the agencies, Commerce or State Department agencies, have been sued by anyone who has been denied a license?

Ms. D'AGOSTINO. We don't know of any cases at State. I am not sure at Commerce.

Senator PRYOR. But to your knowledge, you do not know that?

Ms. D'AGOSTINO. No.

Senator PRYOR. In 1990, as I reported, faster, more responsive licensing the goal, 11,000-plus licenses issued in 7 weeks. The bottom line, fast licensing. Average license issued now in 13 days.

Is this still the prevailing fault of these agencies that deal with granting or denying licenses for arms sales?

Mr. WIGGINS. It appears to be, based upon the findings of our review.

Senator PRYOR. So there is no change in the philosophy?

Mr. WIGGINS. We don't see a lot of change.

Senator PRYOR. I want to thank you. I appreciate what you have done, and I know this Committee and the Congress is going to appreciate this.

I have one final question. Do you have any thoughts that you might give us on legislation that might be constructive in dealing with some of the problems that your very fine report has brought to our attention?

Mr. WIGGINS. I am not sure if, at this time, additional legislation is needed. Again, I think it goes back to getting the right priorities and attention focused to the issue. I think the hearing you are holding today and the work we have done at your request will help bring to light the serious nature and the scope of the problem.

Hopefully, the improvements that have been made in recent years will continue to be made and at a more rapid pace and additional legislation may not be required, but you may have to revisit that at some point in the future.

Senator PRYOR. Mr. Wiggins, if you this afternoon went to the State Department, to the Office of Defense Trade Controls, and filled out an application and you wanted to sell airplane parts overseas, you showed them that you were a citizen, you filled out an application, what are your chances of being granted that license?

Mr. WIGGINS. I would suspect they would be pretty good.

Senator PRYOR. And probably within 13 days or less?

Ms. D'AGOSTINO. If Mr. Wiggins was registered with the Department of State as a registered supplier, he could get a license.

Senator PRYOR. How do you get registered, then? If you are registered, that does not automatically mean that you are going to get a license, does it?

Ms. D'AGOSTINO. That is true, but he is not one of these bad guys on the watchlists.

Senator PRYOR. He is not yet. [Laughter.]

Senator PRYOR. I want to thank you, and I want to thank, again, your team, your very fine team from GAO. We are going to put a lot of this information in the *Congressional Record.* I think our colleagues need to know about it. We are going to call in just a moment some representatives from the Departments of State and Commerce and your report is very much appreciated.

Mr. WIGGINS. Thank you, Mr. Chairman.

Senator PRYOR. Thank you very much.

We are now going to ask our friend, the Honorable William Reinsch, the Under Secretary of Commerce for Export Administration, to come forward. We are actually going to ask both of our witnesses to come and join at the table together. We also have the Honorable Thomas T. McNamara, the Acting Assistant Secretary, Bureau of Political-Military Affairs, Department of State.

We welcome each of you this morning, familiar faces, I might say. We are very grateful for your attendance.

If we might, Bill, why don't we call on you first and you can go forward with your statement, and then Mr. McNamara, and then we will have questions.

TESTIMONY OF THE HON. WILLIAM A. REINSCH,[1] UNDER SECRETARY OF COMMERCE FOR EXPORT ADMINISTRATION

Mr. REINSCH. Thank you very much, Mr. Chairman. Let me first compliment the Committee on its new decor. I haven't been here for a while, and burgundy seats and teal cushions and a multi-colored ceiling, this is very 1990s, Mr. Chairman.

Senator PRYOR. I don't know if this is classified as a perk or not. [Laughter.]

Mr. REINSCH. It is certainly a new thing for the Senate, I can say that.

Thank you for the opportunity to appear. Let me present my statement, then I hope you will ask us some of the same questions you asked the preceding witnesses, because I think that would lead to a constructive dialogue.

As you know, I have strong ties with this institution. I worked over 20 years for the Congress, including 14 years as the principal staffer on these issues for the late Senator Heinz, and most recently, 2 years for Senator Rockefeller.

I was confirmed as Under Secretary on May 2, 1994, about 5 weeks ago. I hope I will be able to make a contribution to the Clinton administration's effort to update and improve our dual-use export control system so we can better achieve our national and economic security goals.

I say dual use, Mr. Chairman, simply to make clear that the Commerce Department is not in the arms business. We are in the dual-use technology business. I leave the question of arms sales and arms sales policy to the State Department. We control the export of critical technology.

As we continue to streamline and reform our control system, it is clear that further decontrol of dual-use technologies can be justified only to the extent that we have an aggressive and credible en-

[1] The prepared statement of Mr. Reinsch appears on page 116.

forcement system that is effective at keeping critical technology out of the hands of would-be proliferators. I am committed to ensuring that such an enforcement system is in place.

I would like to take a few minutes to discuss our procedures for screening export license applications, verifying information, and assuring that licensed exports go only to approved recipients. I will also comment on GAO's report and discuss some of the improvements we have made which address the concerns that it raised.

I believe that our current system functions effectively. There is always room for improvement, there is no question about it, and I am committed to undertaking that improvement.

In reviewing license applications, we rely on many sources of information, some of which have been discussed earlier. They include in-house expertise, intelligence reports, open-source information, pre-license and post-shipment checks, and government-to-government assurances.

Each source has its own strengths and limitations. For example, intelligence information may provide insights not available anywhere else, yet it may also have limited utility because of the need to protect sources and methods. Pre-license check information may give us the advantage of a first-hand visit to the proposed consignee, but his or her candor may be limited by the fact that the checks are overt inquiries by the U.S. Government.

It is important to bear in mind that merely placing a name on our watchlist does not mean that all applications involving that party should be denied. For example, some names are placed on the list in the initial stages of an inquiry for the purpose of gathering additional information. We believe it would be improper to deny all license applications involving a particular party merely on the basis of suspicion or rumor.

One of my frustrations about this issue, frankly, Mr. Chairman, is the implication in the GAO report and in the testimony this morning that every time we grant a license to a party on our watchlist, we have made a mistake. In fact, there are numerous reasons why someone would be on our watchlist that do not and should not imply derogatory information, and I think it does a disservice to our program as well as to the exporter to imply that everybody on our watchlist has in some sense done something wrong and should have all future export license applications denied simply because they are on our list.

In evaluating an application, we use the techniques that are appropriate to the facts of each case. By capitalizing on the strengths of each source of information, we have a system which fosters reliable, timely decisions and which we believe protects our strategic interests.

I have mentioned the principal techniques we utilize: screening, pre-license checks, post-shipment verifications, safeguards, visits, government-to-government assurances, interagency review of license applications.

In addition, we provide the Customs Service computer access to all of our completed licensing decisions. This enables Customs to use the information when examining shipments at the port of export to assure that the goods shipped conform to the statement on the license application. Moreover, it provides valuable information

for their investigations and it provides a mechanism for Customs to give us a warning in time to suspend or revoke a license before shipment to an unreliable party. These actions are, in part, the result of the memorandum of understanding we signed with the Commerce Department last September.

The recent GAO study you requested reviewed our screening procedures in some depth. Let me say in the beginning that although we disagree with some of the details in the report, we believe that its recommendations are constructive and will result in improvements to the system. In fact, we have already implemented or are in the process of implementing virtually every recommendation the GAO made with respect to our Department.

Last year, we received over 25,000 export license applications. The vast majority of these reflect legitimate transactions of law-abiding businesses. However, about one-fifth of those were subjected to heightened scrutiny because they contained one or more names that were on our watchlist. After reviewing these applications in light of existing in-house information, our Office of Export Enforcement was able to recommend that approximately 566 of those licenses not be approved.

Sometimes we need more information than we have in-house to properly evaluate an application that is flagged by our screening system, and we need to employ pre-license checks or safeguards visits. These procedures are among our most important tools to verify the legitimacy of the consignee and the information on the application, because they allow a representative of our Government to observe firsthand the consignee's premises and what is going on there and to interview officials of the firm.

At the same time, they have limitations. They are time and resource consuming. We depend largely on foreign commercial service officers in our embassies to conduct them in addition to their normal duties. Because they entail an overt contact with a consignee by the U.S. Government, they alert all parties to our heightened interest in the transaction.

Last year, we conducted 375 pre-license checks. Eighty-five of those checks, approximately 23 percent, uncovered reasons not to approve an application. We believe that these numbers indicate that we are using this resource appropriately.

We also performed a number of safeguards trips. During these trips, our agents both reviewed the legitimacy of specific export transactions, in other words, did additional PLCs, and provided guidance to both our foreign service personnel and host country officials about our export control program. This program, because of its high visibility, sends a message to foreign governments of the importance the United States attaches to effective export controls.

Our post-shipment check program is a valuable tool for preserving the integrity of our system. When exporters and consignees know that we conduct verifications to ensure that the terms of the license have been complied with, they will be less inclined to submit false statements on their applications.

Likewise, government-to-government assurances elicit the cooperation of foreign governments in preventing diversions. We may seek assurances as to the end use as well as assurances against diversion to other countries.

Each month, we obtain a CD–ROM summary of the shippers' export declarations, representing all of the exports from the United States for the previous month. We analyze the data to detect shipments made in violation of our export control laws. So far in fiscal 1994, our analysts have forwarded over 500 such leads to our investigators.

In addition, our field offices conduct spot checks of shippers' export declarations, or SEDs, in the ports. Our review of SEDs makes it clear to U.S. exporters and would-be diverters that the statements they make on export license applications and other export control documents are subject to Government scrutiny.

In addition to our own expertise at Commerce, we also draw on the knowledge and experience at the State Department, the Defense Department, the Department of Energy, and the Nonproliferation Center when we evaluate license applications. Currently, we refer approximately 54 percent of all license applications to one or more other agencies.

We send the most sensitive applications, about 30 percent of the total, to the Nonproliferation Center for comment on the legitimacy of the parties to the transactions. The NPC queries the various members of the intelligence community for available information on the purchaser, the intermediate consignee, if there is one, and the ultimate consignee. We are working with the NPC toward 100 percent referral of all applications received, and we expect to implement that arrangement in the near future.

That, in brief, is what we do to verify the information that is included in export license applications. It is a process that requires case-by-case judgments as to what techniques to use. We try to select the techniques that best match our needs with respect to each application.

GAO had four recommendations that applied specifically to the Department of Commerce. The first one was that we should "formally assign watchlist data-entry responsibilities among the staff and establish procedures to ensure data entries are complete and up to date".

At the time GAO reviewed our procedures, we had specific staff responsibilities for all categories of watchlist entries except those we received from the Department of Justice. We have since assigned that responsibility. We are refining our ability to ensure data entries are complete and up to date.

I might add, we are dependent in part on the frequency and regularity with which we receive the information from the agencies, which is also an issue we might want to discuss later.

The second recommendation was that we should "share the relevant portion of our watchlist with State on a regular basis and incorporate the relevant portion of State's watchlist into ours".

For years, we have furnished the State Department with our Economic Defense List. This list, currently containing approximately 7,000 names, is the portion of our watchlist which we believe is most relevant to State's mission. The list includes all parties about whom we have specific information linking them to activities of proliferation concern. It also includes those who have been the subjects of unfavorable prelicense or post-shipment checks or who have been sanctioned for export control violations.

As a result of the GAO recommendation, we will consult with State to determine if there are any additional categories of names on our watchlist which are of interest to them and we will provide them with all such names.

In addition, we are prepared to review State's watchlist in further detail to determine what portions may be relevant for BXA.

On the issue of cooperation, which you raised in one of your questions, Mr. Chairman, I simply say I cannot speak with respect to past administrations. I did so from time to time when I was here; I spoke about them. I can tell you that this administration believes in cooperation, I believe in cooperation, and we intend to do that. We are doing that with the State Department. We will give them what they want, and we are happy to review everything they have. We are committed to cooperation.

The third recommendation was that we should "review Commerce's identification number assigning procedures to ensure that multiple numbers are not assigned to the same party". This is something that was discussed in your questions to the GAO.

I believe that we have addressed that problem. Since December 1992, we have had a system in place that we believe has greatly reduced the number of multiple entries for the same entity. It uses a two-step procedure involving computer automation and human quality control review.

Each day, our computer system automatically matches approximately 75 percent of the parties, meaning exporters, purchasers, intermediate consignees, and ultimate consignees, involved in export license applications received that day, based on complex criteria for matching names and addresses with existing entries. After this step, individuals within our Office of Enforcement Support review for accuracy all matches made by the computer.

These employees then compare each of the remaining 25 percent of the parties to a computer-generated list of names and addresses that the software has identified as somewhat similar but not identical to the party on the application. The employee then decides whether the party on the application is the same as an existing party in the data base, and if so, selects the existing party using the same number. If it is different, he or she adds a new entry to that data base.

At one time, when our software was less sophisticated, we deliberately added new entities whenever there was even a slight difference in the name or address or even the punctuation, and we relied on humans to catch multiple entries. As GAO pointed out, that was not entirely a successful system.

As time passes, the licenses representing that practice will be retired and the problem will be diminished. I believe that this procedure, embodying both human and computer review, has reduced the problem, although it has not yet eliminated it. I am committed to finally eliminating it, but that is going to take some time as we go on.

Export Enforcement is working with the Bureau's Office of Information Resources Management to bring about further improvements.

First, we will develop and utilize a special quality assurance report that will allow our managers to quickly identify difficulties that may occur in the process of adding new entities to the system.

Second, we will improve the computer interface used by our employees who add names to the watchlist to alert them to the possibility of more than one record in the database for a particular entity. I believe that will help solve this problem.

The final GAO recommendation was that we should, "when prelicensing checks are conducted because of information from intelligence sources but result in no derogatory information, notify the intelligence sources that the information was not corroborated and discuss whether the application should be approved".

We agree only partially with this recommendation. The intelligence community's important role in export enforcement is one of supplying information. It is the role of the licensing agencies to evaluate this information against other available information and then make the licensing decision.

Having said that, we agree with the portion of the recommendation which states that we should notify the intelligence community when a pre-license or post-shipment check fails to corroborate the intelligence information that prompted it. We are happy to go back to them. We are working with Commerce's Office of Intelligence Liaison, which is our entity in the building that works with the intelligence community, to develop a mechanism to provide this feedback to the intelligence community.

Finally, no export control program, however thorough, can do the job without effective enforcement. To this end, the administration has proposed strengthening our enforcement capabilities in the Export Administration Act renewal that is currently pending before the Congress, which I hope you will have an opportunity to vote on very soon. It will increase penalties for violators and at the same time will simplify and streamline our export control structure.

As I said earlier, I am committed, as is the entire Clinton administration, to strengthening our export control program. We will minimize the burden on law-abiding exporters by avoiding unnecessary controls. We will continue to carefully scrutinize export license applications. We will employ all available resources and methods, as appropriate to a particular case. We will strengthen the system of screening license applications along the lines suggested by the GAO.

Thank you.

Senator PRYOR. I thank you very much.

Let me ask one question, and then we will yield to Mr. McNamara, just so for the record we will know.

In the Department of Commerce, what percentage of the 25,000 applications for licenses are defense-related or military-sales related?

Mr. REINSCH. None of them are munitions. There is a munitions list and there is a commodity control list. The State Department controls items on the munitions list. We control items on the commodity control list.

Defense-related is a fuzzy term. Avionics for helicopters, which is one of the things that is there, that would probably be, if it were a part, would probably be an item that we would control, particu-

larly if it were an item that could be used in both civilian and military items. We tend to control dual-use items that have both applications. Items that have exclusively military applications are on the State Department list.

Senator PRYOR. Good. We are going to come back to you in just a few moments.

Mr. McNamara?

TESTIMONY OF THE HON. THOMAS T. McNAMARA,[1] ACTING ASSISTANT SECRETARY, BUREAU OF POLITICAL-MILITARY AFFAIRS, DEPARTMENT OF STATE

Mr. MCNAMARA. Thank you, Senator. Thank you very much for the opportunity to appear before the Subcommittee.

I would like to read for the record a very short statement, because I believe that we are discussing an extraordinarily important topic, that of export licensing and export controls.

As you in the Congress appreciate, the licensing of arms for commercial export is a complicated and often very sensitive process. It involves billions of dollars of U.S. exports. It involves licensing, which has important implications for national security, for our economic security, for our foreign policy interests, and, indeed, for the well-being of thousands of American employees and their companies.

I know this is an area in which you have long exercised leadership, and the Department appreciates your role, your efforts, and your support. We are committed at the Department of State, as is the entire Clinton administration, to giving the regulation and the facilitation of responsible defense trade the attention and the resources that it deserves. We are committed to improving the efficiency, the speed, and the security with which we carry out these licensing functions.

Before I address specific compliance issues, let me briefly outline some of the steps the Department of State has taken to improve the export licensing process, including the compliance function.

Since 1990, we have reorganized the former Office of Munitions Controls into an Office of Defense Trade Controls, known as DTC, Defense Trade Controls. We have increased the staff from under 30 to over 60. This expansion includes the augmentation of the office with offers from the military services, from the Customs Service, and shortly from the National Security Agency. These augmentees bring a wealth of specialized expertise to this office and they enhance the coordination with which their agencies are able to deal increasingly and more efficiently with the licensing and compliance functions.

We have also strengthened the development of defense export policy through the creation of an additional office, a policy office, originally known as the Office of Defense Trade Policy. In recent months, we have augmented that Office of Defense Trade Policy—it now has over 20 employees—with personnel who worked previously in other bureaus in the Department of State, developing high technology export policy.

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[1] The prepared statement of Mr. McNamara appears on page 123.

In accordance with this broadened mission, we have renamed the office the Office of Export Control Policy, or EXP for short, and we have discontinued the nomenclature "Center for Defense Trade". We have maintained tight cohesion between these two offices and have upgraded the supervisory officer for these two offices to a Deputy Assistant Secretary of State.

We have also obtained permission and are now in the process of filling the position of the Director of the Office of Defense Trade Controls with a Senior Executive Service level official, that is, to continue first-rate management of this very important function. That, we have done since 1990, in terms of upgrading personnel and the numbers and the levels of personnel.

Within the Defense Trade Office, we have invested aggressively in automation of the licensing and compliance operations. We have instituted an electronic remote on-line bulletin board to improve communications with the license applicants and an electronic staffing network to improve the coordination of the State Department with the bureaus in the State Department and with other agencies.

In recent months, we have scored a great success with the long-awaited introduction of electronic licensing submissions. Over 300 companies now participate in this project, a pilot program, and this year, they have submitted over 1,600 licenses via computer as opposed to the hard copy system. The payoffs for the firms and for the Government in speed, efficiency, savings, and security have been significant.

While paper applications remain the norm, we are strongly encouraging the shift to electronic submissions. We are encouraging this shift to electronic submissions in the hope that electronic licensing will become much more prevalent and bring more companies into the program with increasing benefits in terms of efficiency.

Since 1990, we have greatly increased the funding provided to the DTC for performing its mission. We are particularly grateful for you, Mr. Chairman, in supporting the enhanced funding of the office through the "plowback" formula. That has been of great assistance to us. In fact, it is an invaluable asset.

Since 1990, we have been publishing the quarterly magazine *Defense Trade News*, which has received some attention here this morning, to provide information on U.S. export policy and on operational licensing and compliance matters to thousands of readers in the industry, Congress, Government agencies, and other American and foreign audiences.

We have reached out to the industry via an extensive program of in-house seminars and participation in dozens of association conferences and other fora, educating companies on both policy and operational matters to improve Government-industry cooperation and to encourage compliance with legal requirements.

We have enhanced and formalized end-use check programs, including increased scrutiny of high-risk indicators, greater U.S. embassy participation overseas, and foreign government cooperation, both overseas and here in Washington.

We have instituted enhanced compliance procedures, particularly those which implement the legislation which was introduced in 1987. As a result, we have improved registration compliance, dra-

matically increased assistance to U.S. agencies on investigations and criminal prosecutions. We have established a unit dedicated to addressing diversions and Congressional reporting requirements, and we have greatly boosted the number of administrative actions, such as debarments, suspensions, revocations, and company audits.

While we have accomplished much in the past 4 years, we are not resting there. We continue to move apace on electronic licensing and other aspects of automation, including steps to computerize procedures and to enhance coordination between the licensing and compliance functions.

In accordance with the National Performance Review process, we are carefully studying DTC's internal staffing and organization to determine how to improve efficiency and save on personnel costs without sacrificing performance. Increased efficiency with increased personnel has meant increased productivity.

The General Accounting Office recently noted a number of steps which can be taken to improve the handling of the compliance function. We concur with much of what the GAO's analysis has put forward and we have been taking steps to implement most of the specific measures they have recommended. Let me be specific.

First, the GAO review suggested that we tighten procedures for ensuring that the compliance watchlist is properly updated and monitored. We have done so, formally assigning employee responsibility for monitoring the watchlist and for receipt of information from other agencies which is produced at regular intervals for the watchlist.

Second, we have reinvigorated efforts to overcome technical obstacles to the improved exchange of watchlist information with Commerce. We continue to exchange other forms of information besides that of the watchlist relating to export concerns via interagency coordinating groups like the Technology Transfer Working Group and the Missile Technology Export Control Committee.

Currently, the Office of Defense Trade Controls has dedicated a computer system that flags applications for compliance review when the applicants appear on the watchlist. This in-house system has a staff which is currently reprogramming the system in accordance with the GAO's suggestion so that it flags applications when any of the parties appear on the watchlist, and to prevent the flagged license from being logged out and a license being issued until it has been technically reviewed and a staff member has released the application for license.

We are going to do more of this. We have this program right now in its beginning stages and we are going to follow through during a trial period to determine exactly how best to implement this recommendation of the GAO.

Let me note in this regard that, as was noted by my colleague from the Department of Commerce, there seems to be some misunderstanding. A watchlist is that. It is a watchlist. It is not a blacklist. The watchlist merely flags for the attention of the licensing officer and the compliance officer the need to review. It does not suggest that just because a name or even more than one name that is appearing in the license application is on the watchlist that the license need be denied or ought to be denied.

In many cases, the watchlist does not have negative information. It has information of significance and importance. In many other cases, it has negative information which requires a denial of the license. That, I think, is not brought out very clearly in the GAO report.

Third, the compliance division has implemented procedures to ensure that the DTC staff use the computer in documenting their actions. One of the problems we had in the GAO report was that we were not documenting actions taken. We were taking the actions but we didn't have a record to prove we were taking the actions. Since then, we have now gone over this problem and we are examining other systems improvements that we can use to support the compliance efforts that we are making. It is all part of our ongoing enhancement of the computer system within the office.

Fourth, in an effort to attain the same compliance goals with fewer resources, State is developing a system whereby companies would certify that they were maintaining the records of manufacturing and distribution agreements and that they would be subject to spot audits as well as sanctions should they fail to do so.

I would point out that we are reviewing now, and doing a better job, we hope, as a result of some of the recommendations of GAO, with these agreements and with the sales reports that come in annually. It is an enormous amount of paperwork, and to the extent that some inventive and very useful management tools can be applied to this problem, we think we can make great strides in the coming months.

Fifth, GAO recommended that the DTC document or audit applicants to assure that they are U.S. persons, as required by law. In fact, applicants are screened at the registration stage and are also subject to spot check verifications of the U.S. person certification during the licensing procedure. This was not brought out very clearly, either in the report nor in the testimony thus far before the Committee, that, in fact, we are not talking about someone walking in off the street and asking for a license.

The vast majority of all license applications are submitted by persons who have previously registered, and the information, including that as to whether or not they are a U.S. person, which is quite distinct from being a U.S. citizen, that they are a U.S. person is checked both at the time they apply for the registration as well as subsequently we do spot checks during the licensing procedure.

There are elements of the GAO report with which we differ, particularly GAO's view of cooperation between State and Commerce. We find that this has been unduly pessimistic. We think the State and Commerce are cooperating, and I can assure you, Mr. Chairman and all of those listening, that we are cooperating. We have a full and complete effort underway to make sure that cooperation improves and is as good as it possibly can become.

We are particularly concerned and unclear about the methodology GAO used to conclude that about 30,000 of the 33,000 entries on the Commerce list relevant to state were not on State's watchlist. We believe there is already a greater overlap than the draft report States. We have not been able to clarify this with the GAO but we hope to. There are, for example, submissions—just the submissions from the GSA—that amount to several thousand

which appear on both the State and the Commerce watchlists and therefore would tend to call into question figures that were in the draft report.

Moreover, State and Commerce do exchange information regarding export policies, departmental sanctions, and questionable licensing applications via regular meetings and interagency coordination which doesn't show up simply in the exchange of data for watchlists.

There is the Technology Transfer Working Group, which meets regularly. State and Commerce are on that. State chairs it. It is a very useful mechanism for exchanging information.

The Missile Technology Export Control Committee is another interagency committee that both State and Commerce use to exchange information.

We found, Mr. Chairman, that the recent GAO study, like other reviews of the DTC procedures over the years, has been a useful and constructive effort to support defense trade controls and the defense trade control mission. The efforts to improve the defense trade control function is not ours alone; it is truly a team effort, an interagency effort. I can assure you that the interagency effort is being made.

Through training, seminars, conferences, and company audits, we have strengthened U.S. industry's role in the compliance process. Customs, Commerce, and Defense provide critical support and coordination to the Office of Defense Trade Controls, and so do numerous elements within the Department of State outside that office.

Mr. Chairman, we have been particularly gratified by the interest and the cooperation and support that the Congress has provided, which this Subcommittee has provided, and which you personally have provided.

Let me conclude these remarks by saying that while support troops have been critical to DTC's enhancement, it is the line troops at the Office of Defense Trade Controls, the licensing officers, the compliance officers, and the administrative support staff who are the keys to improving the defense trade control process. They have honed in on the problems that they have seen.

They are, in fact, making the office function better through numerous little-noted improvements and innovations. Their daily efforts to serve the interest of the United States in performing their duties, their savvy, their dispatch, have been primarily responsible for the improved performance in recent years.

We want to pledge, and I will pledge, that we will continue to give them the support they need to get the job done and we will continue our commitment to bettering the process.

In fact, I would note Mr. Wiggins's comments about the great strides made in the last few years at the State Department in improving this process and the commitment to fixing those problems which are showing up. That commitment is there, and we expect to make great strides in the future as we have recently.

Thank you very much, Mr. Chairman.

Senator PRYOR. Thank you, Mr. McNamara.

I want to say that I am encouraged by the seeming commitment that you are talking about, or redefining your commitment to hav-

ing more checks and more monitoring of this whole system, which I think has been very, very deplorable in the past.

Let me ask you this. We have talked about this case before. Intelligence agencies in March 1993, last year, raised a concern about a company with an export license to ship U.S. munitions to Singapore. Despite this information which was shared with the State Department, the State Department approved 38 licenses to this company from April to August of last year.

Does this concern you?

Mr. MCNAMARA. I am not familiar with the 38 licenses that you mentioned.

Senator PRYOR. This is from the GAO report.

Mr. MCNAMARA. Yes, but GAO did not give us the specific cases that they chose. We asked them, and we were given those statistics but not the specific cases they applied to. So therefore, it is very difficult for me to review the specific examples that are on those charts because we simply were not given by GAO the information, when we asked for it, that would enable us to cross-check and to give you more information about those specific cases.

But let me make a general comment, if I might, about the question of intelligence information. I think this also applies to Commerce.

Intelligence information is a very valuable tool in determining whether or not a license ought to be issued. Intelligence information, however, is not, in and of itself, automatic grounds for turning down a license. In some cases, the intelligence information, even when negative, is of a nature that it is not grounds for turning down a license. It could be, for example, administrative problems that a company has overseas.

It might be a problem that the company has with a particular end user in a country, and therefore the company, in going to a different country with a different end user and using different shippers and different intermediaries, would have absolutely no reason for turning down licenses.

I don't know and cannot answer the specifics of that case because I was not given the information about the case.

Senator PRYOR. Let me, then, give you a more specific case. Perhaps you and GAO can further go into that particular matter, because I think really flags an issue that concerns me a great deal and I think my colleagues, also.

Let us talk about a more specific case. The State Department issued three licenses in March of 1992 involving a company that had been recently convicted of illegally selling aircraft parts to Iran. The State Department had debarred this company and had even placed it on its watchlist.

My question, why, then, did the State Department issue that particular license to this company after they had violated the export control laws?

Mr. MCNAMARA. On the surface, that sounds like a pretty damning case.

Senator PRYOR. It certainly does to me.

Mr. MCNAMARA. That is right, and as presented here by the GAO, it sounds like a horrendous case. But if we examine a little

more closely, I think we will understand the case a little bit better and see that it is a lot more complicated than the presentation.

First of all, the company referred to had not been debarred. The company referred to was under suspension at the time, that is to say, the first step. Eventually, it did lead to debarment and the company was debarred. But at the time, the issuing of those three licenses was part of a plea bargain agreement in the case in which we had consulted very carefully with national security agencies and with law enforcement agencies.

Those three specific licenses were specifically allowed to go forward because after review—very careful review, very minute review—of all aspects of those three licenses, it was determined and judged to be in the interests of the United states that those licenses be issued.

As part of a plea bargain in the agreement, which led to the debarment of the company, those three licenses were issued. Other license applications by the company were not granted, and subsequently, when the company was debarred, they have now been placed in the position where only those licenses in only certain cases where it is judged to be in U.S. interests that the licenses be granted, would licenses be granted.

That is to say, there was no intention to give that company any special treatment. Indeed, it was part of a judicial proceeding which led to a plea bargain which then led to the debarment in which those licenses were issued.

Senator PRYOR. You mean at the same time they were debarred, they were granted three additional licenses?

Mr. MCNAMARA. No, those licenses were issued because it was in the interest of the United States to issue those licenses and to move those products while the company was under suspension. Subsequently, as a result of court action, they were debarred.

Senator PRYOR. It is a very tortured case.

Mr. MCNAMARA. It is a bit tortured, but it also indicates that it was not a simple oversight. It was not that we did not knowingly do what we did. It was not that it was not carefully reviewed, both from the point of view of law enforcement as well as from the point of view of national security.

Senator PRYOR. With your understanding and patience, I am going to declare a three-minute recess. We will reconvene in about three minutes.

[Recess.]

Senator PRYOR. Our meeting will come back to order. The Committee is back in session now.

You mentioned, Mr. McNamara, about your renewed commitment, I guess we would call it, to check the sales reports of these individuals who have these licenses for overseas arms sales. The GAO testified that they did not see much activity nor much priority placed on reviewing these sales reports. I have stated in the past that I think the review of these sales reports are very, very crucial to whatever end-use studies or end-use efforts, trying to determine where these arms are ultimately going to be going.

I wonder if you would tell us exactly what you are going to do here in this area.

Mr. MCNAMARA. Mr. Chairman, there are a combination of these agreements which are entered into between American companies and overseas companies and governments for the production of these arms, and then there are annual sales reports which are required as a result of these agreements.

What we are going to do is we do now review the basic agreement and make sure that with respect to certain aspects of the agreement, it is in compliance with all laws and regulations relating to the licensing and the export of whatever the——

Senator PRYOR. Excuse me. For every license that is granted by the State Department, there is an agreement signed by the individual or the company with the State Department?

Mr. MCNAMARA. No. These are—in effect, they get a license to manufacture, under a specified agreement, to manufacture overseas or to do some kind of production overseas. That is the basis on which they sort of get into this aspect of the licensing program or come under this aspect of the licensing program. Those agreements, in effect, set out under what circumstances and how and what they would manufacture, produce, or otherwise engage in cooperatively with some company or country overseas.

Senator PRYOR. I am really talking about the sales reports.

Mr. MCNAMARA. That is right. The sales reports are then necessary updatings, and annually they produce these sales reports. Those are what we are, in effect, committing ourselves to doing a review of. At this point, we have neither the personnel nor the resources to review every single one of them, but we do do spot checks of the sales reports to be sure that they are in order and in compliance.

Senator PRYOR. We read from the *Defense Trade News*—it has been the subject of some discussion this morning—from the September and March 1990 issues about fast licensing; faster, more responsive licenses; licensing is the goal.

Is this still sort of the philosophy, do you think, of the Department with regard to the process? The goal is to grant these licenses as quickly as possible?

Mr. MCNAMARA. Clearly, Mr. Chairman, that is neither the goal nor the philosophy. Let me try and put a little perspective on that, if I might.

At the time in 1990 that those *Defense Trade News* issues were coming out, we were dealing with an unusual set of circumstances in the licensing process. We had a backlog of over 10,000 licenses which industry was complaining, some of them four and 5 months old, industry was complaining that we had not moved this stuff at even a reasonable speed.

As a result, there was a great emphasis for a short period of time in 1990, and those are the occasions when those *Defense Trade News* articles came out, at trying to break up the logjam, trying to reduce the backlog, move the licenses out.

We did that. We did it, we think, successfully. We think we did it with adequate security and we did it in a manner which was pleasing both to the Congress, which was putting great pressure on us to do this, as well as to industry, as well as to taking into account our national security concerns.

That was the situation in 1990 for a short period. It was not then, nor is it now, the philosophy to see how quickly we can get the licenses out. We do, however, proceed from—the basic fact is that the vast majority of license applications are submitted by legitimate American industry, legitimate companies which have very legitimate reasons for asking for the license.

Therefore, when the license comes in, those industries deserve expeditious handling of the license within proper procedures. Provided that we can give that type of service and not compromise our national security concerns in issuing an arms export license, we intend to do it.

If you were to look at *Defense Trade News* this year, you would find a greater number of articles which were devoted to case studies of convictions for those who have violated the licensing process; lists of suspended firms, suspended because they had been in violation of either the law or procedure or regulation; information on the Blue Lantern Program, which is our end-use check program through embassies overseas; and a variety of other things which highlight the fact that we want American industry to submit their legitimate licenses but that we are out to catch anybody who thinks that they can somehow trump the system and get a license without being straightforward.

Senator PRYOR. We cited a figure earlier today that we are exploding, I guess tripling, actually, our arms exports, it appears. What about the number of applications that come into your office with regard to requests for licenses? Is this exploding, or is this going up likewise?

Mr. MCNAMARA. Not really. I think value is going up, in part——

Senator PRYOR. The cost of the munitions, the cost of the weapons?

Mr. MCNAMARA. That is correct. We are running approximately 50,000 requests per year. About ten percent of those are turned down, either outright refused or returned without action.

Now that doesn't sound like very much, but one of the major efforts we have undertaken in the course of the last three or 4 years is to educate the industry on the licensing procedure and on what is a legitimate license application, what is likely to get a license and what is likely not to get a license. *Defense Trade News* is just one way. The seminars I mentioned earlier in my opening statement and the conferences we had with industry are another way.

The result, we think, is that we turn off a lot more licenses before the industry or the company even comes to the office to submit the application. We talk to them over the phone. They very often consult with us as to whether or not there is a likelihood that a license may be granted, informally, in advance of their submission.

They are perfectly free to go ahead and submit the license application, and we will give it due consideration. But in many cases, we have been able to explain what the rules and regulations and procedures are, explain what the policy guidelines are.

This administration has reported to this Congress on a conventional arms transfer policy, which explains to industry in much more clear terms than has been heretofore the case exactly what we will allow to be exported. As a result, we think we have turned off a lot of licenses that might otherwise have gotten in there, and

that 50,000 figure might well have gone up to 60,000 or 70,000, but it hasn't.

So when you talk about how many license applications were submitted and how many licenses were turned down, I think we have to try and estimate—and we can't do it in numerical terms so much, but to take into consideration the fact that many license applications are not submitted because of the education program that we are going through with industry, and the cooperative effort that we have undertaken with industry in advance of the actual submission of a piece of paper or a computer submission of a license application.

Senator PRYOR. Each of you this morning, I think, has indicated through your responses to questions and comments of the GAO and myself, you sort of are downplaying, I think, and maybe not on purpose the significance of the watchlists.

GAO has found, pursuant to their report and their study, significant problems with the watchlist, not only the names that are not on the watchlist but if the names are on the watchlist, that those names are not being carefully reviewed.

Mr. Reinsch, would you like to address this, or Mr. McNamara, either one or both?

Mr. REINSCH. Yes, let me say a few words if I may, Mr. Chairman. I think Ted's comment was probably the most apt, that it is not a blacklist. It is a watchlist.

Senator PRYOR. I understand it is not a blacklist. I understand that.

Mr. REINSCH. There are a number of reasons why an entity may be on the list that don't necessarily imply bad behavior. Just as an example, a company may make something that is an exceptionally sensitive item. We may have an interest in wanting to find out who is buying it, who wants it, and we may simply put a company on the watchlist so that we can keep track of what kind of market there is for this particular product.

We would make a decision on a license in each case, depending upon what the destination was, whether it were an ally or not, based on a whole host of factors, but their presence on the watchlist has nothing to do with the company's behavior. It has something to do with the business that they are in, which is a business that is a sensitive one that we would want to watch.

Another example would be companies that, for one reason or another, have had a problem in the past, have been subject to an investigation in the past and might have received a warning letter from us, which is kind of an educational device, or might have received some other penalty aside from being a denied party, which is a very strict penalty.

In those cases, oftentimes, we find that these are companies who have cleaned up their act. They have taken to heart the letter we sent. They have worked with us. They have developed internal export control procedures to prevent the recurrence of the problem they had in the past. The mere fact they have done that doesn't necessarily mean that their name disappears from the watchlist, but it shouldn't mean, I don't think, that we should deny all future export licenses from that company because it had a problem that it has since solved.

Those are some of the entities that end up on the watchlist that cause both of us, I think, to say that this is one of the factors that we have to take into account, and a very important one, but the simple presence of an entity on the list, we don't believe is dispositive with respect to whether we should issue the license.

Mr. MCNAMARA. I would endorse that. In fact, the watchlist—I have no intention of downgrading the importance of the watchlist. The importance of the watchlist is clear to everybody engaged in this process. It is fundamental to our being able to handle this caseload that we have. But a watchlist is that; it is a watchlist.

There are a variety of reasons, not all of which are negative, for putting companies, individuals on the watchlist. It may have to do with the product. If they are dealing with a very highly sensitive and technical product, we want to watch the product, the company that it is dealing with, and where it is sending it, and we want to be very careful that that gets a review regardless of whether we have any qualms about the company.

Senator PRYOR. But according to GAO, respectfully, if I may say, according to GAO, you are not even putting the names on the watchlist. So if you have a watchlist and the names are not on there, then it is a pretty ineffective solution to this problem.

Mr. REINSCH. If I could comment on that, in analyzing—let me say first, Mr. Chairman, that our situation is the same as Mr. McNamara's. We have requested GAO to give us the specific information and they have not done so. We have requested it in writing and they have not done so. Mr. Wiggins said this morning that he would, and I hope he will. That will enable us to look at the individual cases that they cite in their report and make some responses. It is hard for us to be specific at this point.

Let me say first that these problems that they have identified, as I see them, at least with respect to the Commerce Department, fall into three categories.

One is licenses that we issued notwithstanding a name being on the watchlist, which I have just addressed.

Second is the so-called multiple identification problem—a company having more than one number and us missing the screen, basically, even though it is in the screen in a different place. I discussed this situation in my testimony.

The third category is the one that you just mentioned, which is names we don't have on the list.

In our case, I believe GAO indicated they took a sample and found 197 names that they believe should have been on our list that were not. As I said, we asked them for those names; they have not given them to us.

They decided to give us a sample of ten names. Looking at the sample of ten names, we concluded that six of those names were on our list, and we also concluded that the seventh name was added later, after they had given us the sample. That makes us more anxious than ever to get all 197 names, because I am not sure that they are accurate.

The difference, I think in part, is something I alluded to in my testimony, which is time lags. When we get information from the Justice Department or when we get information from other sources, including the intelligence community, every time they come up

with derogatory information, they don't ship it over to us a name at a time. They save it up and we get it irregularly, and not always frequently. And when we get it, we get it in a bunch, and then we have to enter it into our system, and that takes some time. I think it takes too much time.

I think where GAO has a good point is that there is sometimes an unacceptably long lag between a party being identified somewhere in the United States Government as a problem and us receiving and entering that information on our list so that we can keep track of it.

But I do think that a lot of the information that GAO found was missing in fact ends up on our list. It ends up later than it should, but it is there, and we do look at it.

Senator PRYOR. The charts supplied by GAO indicate the number, in just a sampling of cases, the number of companies and where they are based and the derogatory information, from where that information was obtained.

There is one there, Item J, that is the Company J and it is Israel-related intelligence community, but yet they got 137 licenses. This, to me, is an enormous number of particular licenses. This would be from the State Department, not from the Commerce Department but from the State Department.

So we are looking at, more or less, weapons there, Mr. McNamara, and I wonder if you would comment on that.

Mr. MCNAMARA. It is very difficult, as I said, Senator, to comment on that, because we asked for and were refused the information. I notice that of the number of, what, 220 attributed to the State Department there, about 160 of them are Israel. We have a very tight and very careful program going with Israel, and I can't explain either the number of the fact that Israel shows up in so many of those cases.

The 137 cases that are listed on Item J, I simply do not know what the GAO is referring to. We asked them and we were told that we couldn't have the information on the 220 cases. So I apologize, but I cannot answer your question.

Senator PRYOR. Perhaps we can pursue that in another forum, and I would appreciate that opportunity.

Mr. REINSCH. May I say a word about Israel, Mr. Chairman?

Senator PRYOR. Yes, certainly.

Mr. REINSCH. This is a State Department situation, but I was just conferring with my colleagues. We have a number of licenses to Israel. We have very close relationships with Israel, including joint ventures in weapons development, among other things. Israel is also a country that does not belong to the Nuclear Nonproliferation Treaty, does not belong to the Missile Technology Control Regime, is not a participant in the Australia Group.

In other words, it does not belong to any of the multilateral weapons control, armaments control regimes in the world. We have some differences of opinion there that cause us to treat them somewhat differently than some of our other friends and colleagues.

Senator PRYOR. Now are you talking about Commerce or State Department?

Mr. REINSCH. Both of us.

Mr. MCNAMARA. Both. There is a problem with saying suspect parties and then not knowing what the suspicion is about the party. Missing from the watchlist——

Senator PRYOR. We are certainly not at liberty to talk about the names of the companies. We are not going to do that.

Mr. MCNAMARA. No, I understand that, but certainly GAO Is at liberty to give us enough information so that we could check, cross-check, and determine exactly what was involved in those cases, but we haven't been able to do that.

Let me make one comment about missing from watchlists, because it was mentioned in the testimony by the first witnesses here, and that is that in some cases, there are missing from the State Department watchlist companies' names that are on the Commerce watchlist. That is not necessarily a mistake, whereas in the GAO report it suggests that if they are missing, somehow an error has been made. In some cases, they were consciously not put on the list.

Mr. Reinsch pointed out, for example, when Commerce puts on their watchlist some company or some product or some category because it has an interest in monitoring for commercial reasons the flow of those goods or the quantities of those goods or the destination of those goods, such commercial interest, and therefore flagging for a watchlist for a period of time, is something that is of no interest to the State Department, which is looking at it strictly from the point of view of foreign policy and national security.

Therefore, we would probably not put such a flag into our watchlist, but it would be a conscious effort. Therefore, to assume that because there is a discrepancy that this is a mistake is, I think, going a little too far.

Senator PRYOR. Going back to the beginning of our hearing, Mr. Wiggins asked six key questions in his opening statement. For example, are Commerce and State maintaining complete and current watchlists to screen export applications? No. Do the screening systems used by State and Commerce identify all applications involving watchlist parties? No. Do they effectively share information on their watchlists? No. Going on down the line, each one was answered in the negative.

I think the whole reason for this hearing is to get us all to focus on the General Accounting Office evaluation of the present situation, what we have done since 1987, also, what we have not done since 1987 and also what we must do in the future.

I want to say that I am somewhat encouraged by what I think is hopefully a new commitment that I am seeing to really do some constructive and positive things here. I am very concerned about the proliferation of the vast number of arms merchants out in our world exporting arms, selling arms, and I am vitally concerned, so concerned, about the end use of many of these weapons, where they ultimately end up.

I think that both Commerce and State and all the agencies involved have really got to redouble and triple our efforts and our commitment to do something there to really go into this area. I think if people feel that they are not going to get caught if they sell to a party not in our best interest, if they can get by with it

once, they will get by with it twice, and if they sense that that commitment is not there, then I think that we are all in trouble.

Let me, if I might, say on a personal note that the other point I would like to mention is I was very saddened to learn of the death of Mr. Clyde Bryant, who was the Chief of the Compliance Division of the Office of Defense Controls. Mr. Bryant testified before this Committee. As a matter of fact, he answered some questions from myself and from Senator Mitchell in 1987. He worked for 20 years in this very difficult and challenging field of arms licensing. He was truly a dedicated and respected public servant and widely regarded as a real professional in this field. I am sure that he is going to be missed.

We extend to his family and his colleagues our sincere condolences.

Mr. MCNAMARA. Thank you very much.

Senator PRYOR. We want to thank our witnesses today, and once again, we want to thank the General Accounting Office. We will continue monitoring this effort and hopefully we can continue in our relationship in trying to bring this matter to a more efficient solution, and hopefully one that is in the best interest of our country.

Thank you. Our meeting is adjourned.[Whereupon, at 11:33 a.m., the Subcommittee was adjourned.]

APPENDIX

REPORT TO THE CHAIRMAN OF THE FEDERAL SERVICES SUBCOMMITTEE BY THE MAJORITY STAFF

ARMS LICENSING REPORT

Introduction

The U.S. Government views arms exports as a means to accomplish various foreign policy goals as well as a means of maintaining an extensive domestic defense industrial base. Of a global total of $26 billion of arms traded in 1991, the U.S. made up 38% of the total exports market, up from 19% in 1981. The U.S. exported $59 billion in arms during 1987-1991. One area that has received a great deal of attention, especially in the post-Cold War era, is conventional arms exports to the Third World.

The Congressional Research Service reports that the U.S. is by far the leading exporter of conventional weapons to the Third World. The U.S. share was 56 % in 1992, up from 48% in 1991. The dollar amount of this trade was $13.6 billion in 1992 and $14 billion in 1991. With the collapse of the Soviet Union, it is likely that the U.S. will be the major leader in this category for the foreseeable future.

The vast majority, estimated as high as 90%, of this trade by the U.S. occurs on a government-to-government basis under the Foreign Military Sales (FMS) program. However, a significant portion of the exports from the U.S. occur under a commercial license issued directly to a U.S. company for sale to a foreign nation. The Department of Defense, Defense Security Assistance Agency, is responsible for the government-to-government sales, while the Departments of State or Commerce license the commercial sales. The Department of State, Center for Defense Trade, Office of Defense Trade Controls (DTC), licenses those items that are inherently military in nature while the Commerce Department, Bureau of Export Administration, licenses those items that have both military and civilian use. The number of dual-use licenses applications has decreased dramatically over the past five years, from 98,233 in 1988 to 24,068 in 1992. In contrast, applications for munitions licenses, regulated by State, have remained constant at about 54,000 per year.

Shortcomings in State Licensing Office

In 1987, Senator Pryor held two hearings examining the effectiveness of the Department of State in carrying out this function. At that time, the Office of Munitions Control (OMC) at State was responsible for arms export licensing. Senator Pryor found that OMC was not adequately screening the license applications to determine if

ineligible parties were seeking to export munitions. OMC was running a paper-mill, the focus of which was on approving licenses, not on enforcing laws. OMC maintained that it did not have any authority to deny a license unless the applicant had violated the Arms Export Control Act (AECA). However, in written responses to questions furnished after the hearings, OMC stated that the statute and regulations did provide such authority. Key decision makers in the office apparently disputed this as a technical reading of the law and continued to operate under the assumption that they could not deny a license unless the person had violated the AECA. Thus, OMC testified that even if someone had committed treason against the U.S., OMC would still approve their license to export munitions.

In addition, OMC had no criteria for determining which licenses should be subject to an end-use check. Ideally, if a licensing officer has a concern about the license, he or she should ask the U.S. embassy official in the appropriate country to check to see if the export is expected and is going to the authorized recipient. Without a comprehensive watchlist system, however, there is no effective way for the licensing officer to select the questionable licenses out of the 55,000 applications that OMC was receiving annually. State maintained that they did not even keep a watchlist and, in conversations with subcommittee staff, OMC officials stated that the Privacy Act prevented them from compiling such a list. No other federal agency that compiled and maintained such a list, of which there are dozens, thought that the Privacy Act restricted them in this manner.

Senator Pryor was successful in amending the Act to explicitly grant State the authority to deny licenses for persons who had been convicted of felonies or who were otherwise ineligible to contract with or receive a commercial export license from the federal government. (22 USC Section 2778 (g)) The reforms also urged State to establish a more effective system of screening the applications against a watchlist compiled from a number of relevant lists (i.e., Commerce List of Parties Denied Export Privileges, and the GSA Suspended and Debarred List). The amendment also made $500,000 available to State for the explicit purpose of upgrading its computer systems and improve the licensing system of the OMC.

After being criticized by Congress and others, and after the changes mandated by the Pryor amendments were implemented, State increased the resources of the OMC and reorganized it into a new office. It is now called the Office for Defense Trade Controls. In 1987, State had only five licensing officers, three people in its compliance office, and a staff of 30 FTEs for the entire OMC. There are now 53 authorized positions, including 24 FTEs in the Licensing Division and 10 FTEs in the compliance division.

Small Arms Traffic: Scope and Importance of End-use Checks

Since much of the arms sold to the Third World are smaller items, this area receives less attention than the high-value items, for example, large systems such as AWACS or F-15's. In the 1990's, the Arms Control and Disarmament Agency estimates that as much as 13% of the total arms market is made up of munitions and small arms. Much of these small arms are exported under commercial licenses granted by the Department of State. For example, the Subcommittee requested information on small arms exports between 1989 and 1993 to 8 countries : Argentina, Brazil, Columbia, Costa Rica, El Salvador, Guatemala, Mexico, and Peru. The total dollar value of items approved under those licenses for the four years was $106,630,768. The following chart shows a country by country breakdown of the dollar value of the licenses, the number of licenses and the number of end-use checks performed:

SMALL ARMS EXPORTS
Eight Countries - 1989-1993

Country	Dollar Value	Licenses	End-Use Checks
Argentina	$47,747,115	686	7
Brazil	$3,957,533	343	2
Columbia	$643,785	39	0
Costa Rica	$556,274	117	0
El Salvador	$891,916	61	3
Guatemala	$6,766,983	141	3
Mexico	$34,362,973	108	3
Peru	$11,704,189	137	3
TOTAL	$106,630,768	1632	21

The following is a sample of the licenses issued to companies exporting to these countries :

Argentina -- 1) December 12, 1989, $26,441 - pistols
2) March 4, 1990, $47,000 - pistols and revolvers.
3) June 12, 1990, $68,050, pistols and revolvers.
4) Sept 5, 1990, $78,285, pistols and revolvers.
5) Feb. 18, 1991, $98, 337, rifles
6) June 17, 1991, $275,000, pistols and revolvers.
7) Sept. 25, 1991, $439,000, pistols and revolvers.
8) Feb. 14, 1992, $736,801, pistols and revolvers.
9) April 6, 1992, $799,930, pistols and revolvers.
10) July 8, 1992, $2,262,000, pistols
11) Sept. 21, 1992, $3,300,000, pistols and revolvers.
12) Feb 2, 1993, $1,300,000., pistols
13) April 19, 1993, $2,306,662, pistols and revolvers.
14) June 3, 1993, $477,250, pistols
15) August 18, 1993, $572,400, pistols and revolvers.

Brazil --

1) Nov 9, 1989, $36,105, pistols and revolvers.
2) Nov 27, 1990, $52,492, pistol spare parts.
3) Dec. 15, 1990, $82,080, pistols and revolvers.
4) Aug. 29, 1991, $154,925, pistols spare parts.
5) Sept. 28, 1992, $90,400, rifles
6) Dec 2, 1992, $88,360, rifles
7) Feb. 4, 1993, $1,022,500, pistols and revolvers.
8) April 8, 1993, $82,916, pistols and revolvers.

Colombia --

1) October 31, 1989, $101,535, pistols and revolvers.
2) Sept. 16, 1991, $77,249, mortar ammunition
3) July 20, 1993, $100,740, pistols and revolvers.

El Salvador --

1) May 3, 1991, $63,478, pistols and revolvers.
2) Sept. 25, 1991, $96,159, pistols and revolvers.
3) Nov. 17, 1992, $50,000, pistols and revolvers.
4) Dec.7, 1992, $58,049, pistols and revolvers.

5) Jan. 11, 1993, $62,600, pistols and revolvers.
6) May 5, 1993, $42,857, pistols and revolvers.
7) June 14, 1993, $81,728,pistols and revolvers.

Guatemala --

1) July 12, 1989, $20,120, pistols and revolvers.
2) Nov. 15, 1989, $46,770, pistols and revolvers.
3) Feb. 8, 1990, $84,000, pistols and revolvers.
4) Mar. 1, 1990, $11,404, M-16 rifles
5) Oct. 12, 1990, $58,700, pistols and revolvers.
6) Oct. 3, 1991, $97,225, pistols and revolvers.
7) Jan. 27, 1992, $108,750, pistols and revolvers.
8) Mar, 3, 1992, $66,450, pistols and revolvers.
9) Mar. 4, 1992, $31,700, rifles
10) June 19, 1992, $189,460, pistols and revolvers.
11) June 29, 1992, $353,466, pistols.
12) Aug, 17, 1992, $59, 980, pistols
13) Oct 21, 1992, $92, 138, pistols
14) Feb. 15, 1993, $161,250, rifles.
15) April 20, 1993, $508,293, rifles.
16) June 11, 1993, $729, 068, pistols.
17) July 13, 1993, $1,487,500, rifles.

Unfortunately, these licenses are not a reliable indicator of the total amount of munitions that we are exporting to those countries. Despite the existence of an approved license, U.S. officials have no way of knowing how much of any item is actually shipped. These licenses are merely an authorization to export. The actual export either occurs or does not depending on whether the company actually completes the sale.

The Subcommittee found in its review that the DTC is able to conduct end-use checks on only a small sample of licenses. For example, in the material supplied to the Subcommittee by the Department of State, licenses were approved for nearly $900,000 worth of pistols, revolvers and rifles for El Salvador between 1989 and 1993. Given the civil war in that country, one would think that careful attention would be paid to each of the 61 licenses. State performed an end-use check on only three of the licenses for shipment of these munitions to El Salvador. In the case of Guatemala for the same time period, companies received licenses for $6,766,983 worth of pistols, revolvers, and rifles. For the 141 licenses approved during this time, State performed an end-use check only four times.

As noted on the chart above, for the hundreds of licenses involved in the exports of small arms whose approved value was over $100,000,000, the State Department conducted only 21 end-use checks to see if these pistols, revolvers, and rifles were going to the authorized recipient.

Without conducting an end-use check, there is no way of knowing whether any of these small arms actually went to the country and the party listed in the license application. The Subcommittee believes this is evidence of an office that lacks any real interest in aggressively determining if U.S. munitions are only going to the appropriate place. Unfortunately, this finding is confirmed by investigations conducted by both the General Accounting Office (GAO) and the State Department Inspector General (IG).

GAO Report

On April 15, 1992, Senator Pryor requested that GAO investigate the State and Commerce Department's export licensing operations. Senator Pryor stated , "What I hope to learn from the GAO is whether there continues to be a lack of mismanagement within the DTC, lack of real interest in controls on the part of the State Department ..." In reaction to an audit by the State Inspector General that had found continuing problems and was released shortly before Senator Pryor's GAO request, Sen. Pryor stated, "Since DTC has been the recipient of increased staffing and funding over the past few years, I had hopes there would have been significant improvements in their license review process since your (GAO) last review in 1987. Either the DTC needs to reorganized again or that office is not being allowed to do its job."

GAO FINDINGS

Huge Gaps in the Watch lists maintained at both agencies.

Commerce and State both have watch lists that they are supposed to use to screen every applicant for an export license. Therefore, the system is handicapped if the watch lists are not comprehensive. The GAO has found huge gaps in the watch lists where both agencies have failed to simply add to the lists the names of persons who have been convicted of export violations, been denied export privileges, or have derogatory intelligence information on them. The GAO states that the agencies' watchlists are not accurate, complete and current.

The following are the gaps found in the Commerce and State watch lists:

A) Justice list of Significant Export Violation Cases. While these names are available to both agencies, and in fact this list is publicly available, not all of the names are included on the watch lists:

1) DTC -- Missing 51% of the convicted persons
2) Commerce -- Missing 83% of the convicted persons

B) Treasury list of designated agents of Foreign Governments. These are parties prohibited by statute from making an arms export.

1) DTC -- Missing 4 names
2) Commerce -- Missing 33 names

C) Main State intelligence information; this data produced 45 questionable names in a three month period. These were persons or companies that were involved in activities which were potentially adverse to U.S. interests.

DTC -- Missing 26 names.

D) Commerce Economic Defense List. This internal list is maintained by Commerce and is comprised of various lists including suspected terrorists, Treasury Department Prohibited Parties list, and a special list of Chinese companies that had attempted to subvert U.S. export controls.

Even though Commerce makes this list available to DTC, DTC's watch list is missing 398 names, of a total of 1,011 contained on the Commerce list.

E) Blue Lantern. This is a program initiated by State in September 1990 to conduct end-use verifications of potential exports. GAO found that, during the time of their review, negative pre-license checks had produced 39 names of suspicious persons.

DTC was missing 36 of these names on their watch list, approximately 92% of the questionable persons identified by State itself.

F) DTC was missing 18 names on the GSA Suspension and Debarment list.

G) DTC and Commerce do not share their watchlists, despite their many common interests. GAO found that 5,000 entries on DTC's watchlist that would be of interest to Commerce and were not on Commerce's watchlist. Roughly 30,000 entries on Commerce's watchlist that would be of interest to DTC were not on DTC's watchlist.

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TOTALS – DTC's watchlist is missing 27% of the readily available names
Commerce's watchlist is missing 27% of the readily available names

SIGNIFICANCE OF WATCHLIST FAILURES

The result of these huge gaps is that DTC and Commerce licensing officers do not have a comprehensive system of attaching a red flag to any application that should be on the State or Commerce watch list. Thus, parties who have been suspended or debarred, or have been denied export privileges by Commerce, or about whom there is derogatory intelligence information, can actually have their application reviewed and approved without any information bringing this important matter to the attention of the licensing officer. In GAO's words, "licenses were issued to some of these parties without the benefit of weighing the derogatory information available against them."

In addition, the GAO also found that both agencies have flawed screening systems. This means that even when names are on their watchlist, due to inadequate procedures, their screening system does not guarantee that the application will be highlighted for further review. In these cases, the application is then handled as a routine matter and no national security review is conducted. For example, at the State Department, if the end-user is questionable but the applicant is not on the watchlist, then the application would not be flagged for review. Commerce has a more sophisticated system, but due to the assigning of multiple identification numbers, their system often breaks down as well. For example, GAO found that "license applications involving parties on the watchlist may not always be caught because the parties may be assigned identification numbers that do not carry watchlist flags."

EXAMPLES:

** State granted three licenses to companies that should have been on their watch list as a result of their Blue Lantern program.

** Commerce granted licenses to several companies even though a pre-license check turned up questionable information on those companies.

** Commerce put an Indonesian company on its Economic Defense List. Since DTC did not put the name on its list for months, DTC approved a license to that company.

** Commerce issued licenses to people that DTC had identified as questionable under their Blue Lantern program.

** Dozens of licenses went to applicants who should have been on both of the watch lists due to intelligence information. For example, Commerce issued 53 licenses to parties on the Intelligence watchlist, because their own pre-licensing check could not produce any information that would cause them to deny the application. Commerce states that it cannot deny a license on national security grounds as part of an agreement with the intelligence community. GAO states that Commerce should find another reason to deny the application, or attempt to develop the intelligence further.

** A company identified by Commerce in 1990 as a concern due to missile technology export reasons was granted 40 licenses by State. This means that Commerce had reason to believe that this company was involved in an attempt to subvert U.S. laws governing the export of missile technology.

** A company identified by Commerce as subject to a Denial Order, which denies any company the privilege of exporting from the U.S., was granted two licenses by State.

** A company convicted in 1992 of violating the Arms Export Control Act for illegal exports to IRAN was granted three licenses by State.

GAO found that between 1990 and 1993, State and Commerce issued 230 licenses to parties whose names should have been on the agencies' watchlists, but were not. They also found that in the same time period, the agencies issued over 800 licenses involving parties who were on their watchlists but the flaws in the screening system did not flag these applications for further review.

Some of these cases are blatant examples of ineligible persons receiving munitions licenses. However, a related concern is that too often companies that are involved in activities that cause a national security concern in a critical area are not put on the watch lists. When these companies are granted licenses even though they have been identified as a concern for national security reasons, and the licensing officer is not made aware of these concerns, then there is no assurance that the approved licenses are awarded for legitimate transactions. At the very least, any application from companies that are a concern for national security reasons should be subjected to an end-use check. The following three cases are examples of where such companies received munitions licenses and the licensing officer was unaware of the outstanding concerns about the companies:

** A company identified by Commerce as a concern for nuclear proliferation reasons was granted two licenses by Commerce.

** A company identified by Commerce as a concern for missile technology reasons in 1992 was granted a license by Commerce.

** A company identified by State in 1991 as a concern for missile technology reasons was granted three licenses.

When the examples above are reviewed more closely, it becomes clear why both agencies are in need of comprehensive, effective, and timely screening systems. For example, the company convicted in March 1992 for the illegal export to Iran received three licenses approved by State between July and December 1992, four months after the conviction. At Commerce, a company identified on June 23, 1992, as a concern for missile technology reasons was given a license by Commerce two weeks later. Obviously, information needs to be updated on a daily basis. Not only are the watchlists not updated on a daily basis, they are not even updated on an annual basis. Information developed by each agency is not routinely placed upon the watchlists. Thus, intelligence information at Commerce or end-use information at State that is relevant to the eligibility or bears on the integrity of various companies is not put on the watchlists on a routine, comprehensive basis. Furthermore, publicly available lists, like the Commerce list of Denial Orders or the GSA Suspension and Debarment list, are not routinely added to the watchlists.

OTHER GAO FINDINGS:

Disarray in files prohibits DTC from detecting unauthorized sales.

DTC is not routinely collecting or reviewing the annual sales reports by U.S. and foreign companies involved in the manufacturing, licensing, and distribution agreements as required by federal regulations. DTC files are in disarray with a large percentage missing even a signed copy of the final agreement.

Without a final agreement or the annual report, DTC cannot detect signs of unauthorized sales or transfers.

DTC permits self-policing of U.S. Citizenship Requirement

DTC relies strictly on applicants' certifications that the persons signing the applications are U.S. persons. NO DOCUMENTARY EVIDENCE IS REQUIRED.

GAO tested a sample of 40 approved cases to see if the applications contained the required certifications. 8 of the 40 DID NOT have the proper certification.

DTC relies on self-policing by the applicants to ensure that only U.S. persons receive a license.

OTHER REPORTS ALSO POINT TO SHORTCOMINGS

INTER-AGENCY IG REPORT – SEPTEMBER 1993

The State Department Inspector General (IG) continues to find that the end-use checking system is not adequate. In a report dated September 1993, the IG found "considerable disarray " in the State end-use program at most of the 11 posts visited by the IG personnel. The review of State's end-use program, called Blue Lantern, found that most of the posts they visited did not have a complete set of instructions readily available as to how to carry out the program. Even though DTC had notified each post to designate a Blue Lantern official, the IG found that there is still confusion at some posts as to who is the responsible official. As a result, a number of Blue Lantern requests had not been fulfilled. Finally, at three of the posts, Blue Lantern coordinators did not keep files or records of their activities. While State maintains that they have corrected these problems, their track record does not instill confidence.

State informed the Subcommittee that the number of end-use checks have increased from 38 in 1990 to 478 in 1993. The "disarray" found by the State IG undercuts the supposition that because State's end-use numbers have increased, State is therefore doing a better job of verifying if the export is legitimate. If State actually had an effective screening system and an effective end-use checking system, these numbers would then be a meaningful indicator of improvement. As it is, the Subcommittee believes that this means very little.

The Commerce IG, in the same inter-agency report in September 1993, found several deficiencies in the licensing function at Commerce. The IG found that Commerce was not checking to see if exporters were complying with conditions that the Department had placed on their licenses. In fact, the IG found that exporters had only a four percent compliance rate with the requirement that they submit documentation showing they have followed the condition on the license. Commerce was taking no action to contact the vast majority of exporters who were failing to submit any compliance information.

The IG also found problems with Commerce's end-use check program. In FY 92, Commerce completed 568 checks and 177 verifications. Commerce has no plan on how to use these checks to ensure the integrity of the licensing program. In addition, the IG also found that the posts carrying out the checks were using foreign nationals, despite the guidance by the Export Administration which discourages this. Five of the posts were conducting these checks by telephone because they lacked the funds for on-site visits.

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STATE IG INSPECTION REPORT – SEPTEMBER 1993

In September 1993, the Department of State Inspector General conducted an inspection of an embassy located in a western nation that is a key U.S. ally. A portion of the inspection involved a look at how well this post was implementing the Blue Lantern program. The following is the IG's assessment:

> The Blue Lantern program for achieving compliance with U.S. defense trade controls (DTC) does not work well in (U.S. ally). (The program is intended to be a systematic end-use verification procedure that includes prelicense and post-shipment checks. It was initiated in September 1990 by the Office of Defense Trade Controls...) The Department's requests to Embassy (blank) for checks are poorly framed, provide little useful search data, and rarely indicate why they are being made...
>
> Some Blue Lantern requests from Washington have appeared frivolous...Many requests are encyclopedic lists or parts or equipment numbers with little or no indication of either end-use or importance. The Office of Northern European Affairs now filters requests before approving transmission to (blank). This process has cut the number of requests and has improved their quality. Nevertheless, many (blank) responses are incomplete and offer little hard evidence.
>
> As presently constituted, Blue Lantern does not work in the (blank), is an irritant in the bilateral working relationships, and, above all, detracts from U.S. efforts to prevent diversion of strategic commodities.

LEARNING THE WRONG LESSON

One explanation for the numerous problems outlined above is that DTC learned the wrong lesson from its1987 experience. In addition to congressional and GAO criticism, the U.S. defense industry was also highly critical of State's licensing operations at that time. Given that the metamorphosis from OMC to DTC has not resulted in a more effective system of screening and more aggressive end-use checks, it appears that State learned that speed was the most important objective. There are some indicators of how State views the priorities in its licensing operation:

First, the name change serves as a public declaration that the mission of the office has changed from one of control to one of promoting "defense trade." Shortly after the name change, then Assistant Secretary of State, Lawrence Eagleburger, sent a memo to all U.S. embassies ordering them to "get on board" the mission of assisting U.S. defense companies in exporting their goods.

Secondly, the following excerpts from Defense Trade News, the official Bulletin from the Center for Defense Trade at State, make it clear that one of the key priorities of the new office is to expedite defense trade. Here are two articles from the March 1990 issue of the Defense Trade News:

"Control Office Expanding, Faster, More Responsive Licensing The Goal", "Project Accelerate A Success, 11,000 licenses Issued in Seven Weeks".

The lead article states, "The Department's purpose in creating the Center for Defense Trade is to provide improved export licensing services and defense trade policy guidelines to U.S. defense industry." The article goes on to discuss the need to remove unnecessary impediments to defense trade. Referring to Congressional and industry complaints, it concludes that in order for the U.S. defense industry to stay competitive, the munitions licensing function must be updated.

From Defense Trade News, June 1990:

"Project Accelerate Institutionalized ; 92% of Cases Issued or Staffed Within 10 Days." This article states that State took as its most important guideline the urging by the Congress to determine within 10 days if licenses should be referred to other agencies. This was only one of Congress's recommendations, but State chose this as it focus. It boasts that 66% of all cases were reviewed and licenses issued within 10 days. It is no wonder that for the above licenses to the Latin American countries State performed relatively few end-use checks.

From Defense Trade News, September 1990:

"The Bottom-Line: Fast Licensing. Average License issued in 13 days."

This article states that the overall objective is to "institutionalize a fast, predictable export licensing process..." While it mentions the AECA in passing, it largely involves a statistical analysis of how quickly DTC is processing the licenses. The whole focus is doing it quicker, rather than ensuring all of our defense and foreign policy goals are satisfied.

The Congress was certainly interested in a more efficient arms licensing office. However, to interpret this as a mandate to simply more quickly process the licenses is a misreading of the criticisms from the Congress, the GAO and the State IG.

Another indicator of the focus of the State Department is contained in the most recent iteration of the regulations that implement the Arms Export Control Act. In the July 22, 1993, Federal Register, the International Traffic in Arms Regulations (ITAR) summary states that "The rule clarifies existing regulations and reduces the regulatory burden on exporters of defense articles and services." While reducing the regulatory

burden is often a laudable goal, when the issue at hand is the export of munitions, reducing the regulatory burden should not be the sole or main focus of the government's efforts.

The ITAR notice states that one of the most significant changes was increasing the validity period of a license from three to four years. Other changes added several exemptions from licensing requirements for: 1) articles in furtherance of approved manufacturing license agreements; 2) spare parts under $500 to support previously approved exports; 3) intra-company transfers of items sent abroad; 4) unclassified models that are nonoperable; 5) items previously licensed for temporary export to trade shows; and 6) temporary imports for repair.

While some of these changes seem to be modest, the totality results in a further loosening of control. As noted above in the discussion of the licenses for export to Latin American nations, DTC had no idea when items were actually exported within the three year period of the validity of the license. Changing the validity period to four years only increases the uncertainty as to how much we are actually exporting to any given country. This increased time period, combined with the six new exemptions, results in an ever looser system of monitoring U.S. munitions exports.

Conclusion

The State Department, in response to any criticism of their present system of licensing, responds that they are building "higher walls around fewer items." This would be of some solace if there were not so many holes in the walls. The extensive gaps that GAO found in the watchlist at both State and Commerce, gaps that resulted in the granting of licenses to either ineligible or questionable persons, demonstrates that the present licensing system is seriously deficient.

In 1987, after finding massive deficiencies and apparent rubber-stamping of license applications, there was discussion of transferring the State Department licensing function to another agency more able to carry out the control functions. Given the continued deficiencies at DTC, such discussion is likely to continue.

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Federal Services,
Post Office and Civil Service,
Committee on Governmental Affairs
United States Senate

For Release on Delivery
Expected at
9:30 a.m. EDT
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EXPORT CONTROLS

License Screening and Compliance Procedures Need Strengthening

Statement of James F. Wiggins, Associate Director,
Acquisition Policy, Technology, and Competitiveness Issues
National Security and International Affairs Division

GAO/T-NSIAD-94-203

Mr. Chairman and Members of the Committee:

It is a pleasure to be here today to discuss the results of our review of the automated export license screening and compliance procedures at the Departments of State and Commerce.[1]

In a 1987 report on licensing activities at the Department of State's Office of Munitions Control, now known as the Office of Defense Trade Controls (DTC), we reported that DTC was not routinely using readily available information to screen license applications to help identify those potentially needing closer scrutiny.[2] In 1991, DTC established automated license application screening procedures to identify ineligible and undesirable parties. Commerce has had automated license screening procedures since 1984. We believe that effective license screening is essential in the licensing process because it provides the first line of defense against issuing licenses to parties seeking to misuse or divert sensitive U.S. items and technology.

Our most recent work in the export licensing area focused on the effectiveness of the license screening procedures at both the Departments of State and Commerce and some compliance issues that are applicable only to State. We covered both agencies because, as you know, State licenses munitions exports and Commerce licenses exports of sensitive dual-use items. Our review uncovered several weaknesses in the screening procedures at both agencies, and in the compliance area.

I would like to focus on six key questions addressed in our review.

-- Are Commerce and State maintaining complete and current watchlists to screen export applications?
-- Do the screening systems used by State and Commerce identify all applications involving watchlist parties?
-- Do Commerce and State effectively share the information on their watchlists?
-- Is Commerce making the most effective use of intelligence information to screen export applications?
-- Is State monitoring agreements involving the manufacture and distribution of defense articles outside the United States?
-- Does State verify that only U.S. persons are granted munitions export licenses?

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[1]Export Controls: License Screening and Compliance Procedures Need Strengthening (GAO/NSIAD-94-178, June 14, 1994).

[2]Arms Exports: Licensing Reviews for Exporting Military Items Can Be Improved
(GAO/NSIAD-87-211, Sept. 9, 1987).

AGENCIES' WATCHLISTS ARE NOT COMPLETE AND CURRENT

Commerce and State compile separate watchlists to use for screening license applications. Watchlist names serve to prompt closer review of export license applications. The watchlists include, for example, individuals and companies that (1) have been convicted of export violations, (2) are subjects of unfavorable pre-license or post-shipment checks, (3) are under economic sanctions imposed by Treasury, (4) have been identified as known or suspected diverters or proliferators by intelligence reports, or (5) have been debarred by Commerce or State from export activities.

We obtained documents and information State and Commerce told us they use to update their watchlists and checked to see if the names had in fact been entered onto the agencies' watchlists. We checked over 2,100 names that should have been included on the State watchlist and over 700 names that should have been included on Commerce's watchlist. Of the names we checked, we found that each agency had failed to include about 27 percent of the names on their watchlists.[3] For example, we examined 92 names listed by the Department of Justice as fugitives indicted for or convicted of significant export control violations. At the time we checked, Commerce had not placed 69 of these names on its list, and State had not placed 47 of these names on its watchlist.

We believe the reason so many names are missing from the agencies' watchlists is that the agencies have not clearly assigned data entry responsibilities and do not have adequate procedures to ensure names are entered systematically and in a timely manner. As a result, names from the documents are haphazardly entered and updated.

We searched State's and Commerce's licensing databases to see if any licenses had been issued to the parties whose names should have been but were not on the watchlists. We found a total of 224 such licenses issued to 15 parties between fiscal year 1990 and August 1993.[4] For example, in January 1992 a State Blue Lantern inspection revealed that a company was selling F-16 parts without U.S. authorization, but the name of this company was never placed on State's watchlist. In May 1993, State approved an export license involving this company.

At this point, I want to emphasize that we are not saying these licenses should not have been issued. What we are saying is that these licenses were issued without considering the negative or derogatory information regarding these parties. Had the

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[3]Details of this analysis are in attachment I.

[4]Details about the 224 cases are in attachment II.

information been considered, the licensing decisions may or may not have been different.

Our report recommends that State and Commerce formally assign watchlist data-entry responsibilities among staff and establish adequate procedures and guidance to ensure data entries are complete and up-to-date. In a response to our draft report, Commerce stated that it has had formalized procedures since 1989 for controlling what information should be entered on its watchlist and by whom, but acknowledged that, until October 1993, it did not have procedures for entering Department of Justice names. Commerce also did not address the lack of procedures and guidance for gathering information from State's Blue Lantern program (a pre- and post-license check program) and from intelligence reports. State commented that, since our review, it has assigned responsibility to a specific employee for monitoring its watchlist and for ensuring the list is updated at regular intervals. We believe State is taking the proper action, but we will have to follow up on and verify the effectiveness of that action.

AGENCIES' SCREENING SYSTEMS DO NOT ALWAYS CAPTURE APPLICATIONS WITH WATCHLIST NAMES

State's and Commerce's screening systems are designed to identify, or flag, applications that have watchlist names on them so that they can be scrutinized by enforcement staff. However, we found that their systems do not always do that. At Commerce, we identified 851 license applications with watchlist names that slipped through Commerce's watchlist screening system without being reviewed by its enforcement staff. While 75 of these applications were eventually denied or returned without action, 776 were approved. For example, Commerce approved two licenses involving a company placed on its watchlist for nuclear proliferation reasons. The screening system had not flagged the applications, and they were not sent to enforcement staff for review.

Similarly, at State, based on a sample of 86 license applications,[5] we found 83 license applications involving 28 companies slipped through State's screening system without being reviewed by its compliance staff. Seventy-one of these licenses were approved. In a case outside our sample, a company convicted of illegally selling aircraft parts to Iran had been debarred by State from future export licenses and placed on State's watchlist. Nonetheless, in 1992 State issued four licenses involving this company without the applications being flagged by its screening system. Further details on the watchlist parties that slipped through the screening systems at State and Commerce are in attachment III.

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[5]We selected for our sample only licenses processed within 2 days that involved State watchlist parties.

Again, we are not saying those licenses should not have been granted. What we are saying is that they were granted without considering the negative or derogatory information regarding the watchlist parties.

We believe that weak internal controls are causing Commerce and State to miss applications involving watchlist parties. For example, Commerce assigns identification numbers to all exporters and consignees in its database to automatically flag watchlist parties on license applications. However, in many cases Commerce has assigned multiple identification numbers to the same party, not all of which have watchlist flags. As a result, license applications involving parties on the watchlist may not always be caught by the screening system.

There are several possible explanations as to why licenses slipped through State's screening system. State's system is less automated than Commerce's and largely relies on staff to manually review a computer report to find the name matches between applications and its watchlist. Also, unless the matched watchlist party is the applicant, the system does not automatically flag the application or send the case to the Compliance Division for review. Moreover, unlike Commerce's system, State's system does not track the review made by compliance staff, nor does it prevent a license from being issued until after compliance staff have completed their review. As a result, a case could slip through because the staff did not manually spot the match or because the compliance specialist did not complete a review of the case. There are additional technical limitations in State's matching program that could also cause a case to slip through. Because State's process is not well documented, it was difficult for us to determine exactly why 83 of the 86 cases we examined slipped through.

Our report recommends that State and Commerce review and make the necessary changes to their systems' design and screening procedures to ensure that applications with watchlist names will be caught by their systems. In its response, Commerce said that it has been attempting to eliminate multiple identification numbers since the fall of 1992, but our analysis of the Commerce data shows this effort has not solved the problem. State agreed to consider redesigning its system but is concerned that a new system might reduce its licensing efficiency. We believe that a thorough review of applications involving parties on the watchlist is more important than issuing licenses quickly. Moreover, a redesigned system may actually improve State's licensing efficiency.

AGENCIES DO NOT SHARE THEIR WATCHLISTS

State and Commerce do not routinely share information from their watchlists with each other.[6] While some entries on each agency's watchlist are of unique interest to only that agency, thousands of names are of common interest to both Commerce and State and, because they are not shared, are not being used to screen export applications for questionable parties.

We compared State's and Commerce's watchlists to determine how many entries of interest to both agencies are not being used to screen applications. About 5,000 entries on the State watchlist relevant to Commerce were not on Commerce's watchlist. Similarly, about 32,000 entries on the Commerce list relevant to State were not on State's watchlist.[7] These entries represent negative or derogatory information on companies and individuals that State and Commerce are not using in their licensing reviews.

Each agency has processed licenses involving parties on the watchlist of the other agency. State processed about 6,700 licenses involving about 300 relevant parties on Commerce's watchlist that were not on State's watchlist. State approved about 6,100 of these licenses. Similarly, Commerce processed 17 licenses involving 3 parties on State's watchlist that were not on Commerce's watchlist and approved 9 of these licenses.

Because of multiple entries in the agencies' watchlists and our computer name-matching approach, our estimates likely overstate the number of entries on one watchlist of interest to the other and the numbers of licenses issued involving these parties.[8] Nevertheless, our methodology provides a valid indication of the potential problems created by the agencies' failure to share their watchlists. For example, in June 1991, Commerce placed a company name on its watchlist because of an unfavorable post-shipment check. State did not have this name on its watchlist and approved three licenses involving this company.

Our report recommends that State and Commerce share the relevant portions of their watchlists with one another on a regular basis.

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[6]Commerce does provide State a copy of The Economic Defense List. This report is published only once a year, however, and contains only a partial listing of names from Commerce's watchlist.

[7]Details of these analyses are in attachment IV.

[8]These limitations are discussed in more detail in appendix V of our report.

COMMERCE HAS NOT MADE THE MOST EFFECTIVE USE OF INTELLIGENCE INFORMATION TO SCREEN APPLICATIONS

Commerce officials told us that they do not deny a license based on intelligence information in its watchlist unless it is corroborated by a negative pre-license check or other information. However, recent GAO and Inspector General reports have noted limitations and recommended improvements in Commerce's pre-license check program.[9]

Because Commerce must provide detailed explanations to exporters who are denied licenses, the intelligence agencies do not want Commerce to deny licenses solely on the basis of intelligence information without first consulting them. Consequently, under current procedures, Commerce enforcement agents essentially use intelligence information as a lead to develop collateral information that can be used to deny a license. For example, when the application screening process identifies a party as a potential diverter or proliferator based on intelligence information, Commerce may request a pre-license check on the party. If the check produces negative or derogatory information, Commerce can use that as the basis for denying the license. When the checks do not produce negative results, however, Commerce does not routinely refer such cases to the intelligence sources to (1) assess the merits of the intelligence information, and (2) determine whether the information could be sanitized to permit its use in denying a license application. From fiscal year 1990 to August 1993, we found 49 licenses that had names on the Commerce watchlist based on intelligence information and that Commerce approved after pre-license checks failed to corroborate the negative information in the intelligence reports.

In our report, we recommend that Commerce routinely refer to intelligence sources those cases for which pre-license checks have not corroborated the derogatory intelligence information. In consultation with the intelligence sources, such cases should be reviewed to (1) assess the merits of the intelligence information, and (2) determine whether the intelligence information could be sanitized to permit its use in denying a license application. Although Commerce implied in its response to our draft report that it routinely consults with the intelligence sources regarding those types of cases, both Commerce and intelligence officials told us that it has taken this extra step to consult with the intelligence source only about three times in the past 5 years.

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[9]Nuclear Non-Proliferation: Export Licensing Procedures for Dual-Use Items Need to Be Strengthened (GAO/NSIAD-94-119, Apr. 26, 1994), and The Federal Government's Export Licensing Processes for Munitions and Dual-Use Commodities (Joint State/Commerce/DOD/Energy Inspector General Report, Sept. 1993).

STATE HAS NOT MONITORED MANUFACTURING AND DISTRIBUTION AGREEMENTS EFFECTIVELY

State requires the U.S. company or its licensee to submit annual sales reports when entering into an agreement to manufacture or distribute defense articles outside the United States. The reports are to include information on sales or other transfers of the licensed articles, by quantity, type, dollar value, and purchaser or recipient. However, State officials told us that, due to limited staff, they have not routinely collected or reviewed these reports. We noted that, notwithstanding limited resources, State had not assigned oversight responsibility for the agreements among its staff.

State officials also acknowledged that the agreement files were in such disarray that they could not distinguish between those companies that had failed to submit the reports and those that had submitted reports that may have been misplaced. Some files were even missing copies of the final agreements. State officials attributed the poor management of the files to a lack of staff and a move of their document storage facility a few years ago. State is now attempting to bring the files up to date by contacting companies to determine what records are missing from the files. Without the signed agreements or the annual sales reports, State cannot check for indications of unauthorized sales or transfers.

Our report recommends that State assign oversight and monitoring responsibilities for the manufacturing and distribution agreements among its staff and ensure that the files on these agreements are updated. State responded that it is now considering a system whereby companies would certify that they were maintaining these records and would be subject to sanctions if they fail to do so. We believe this would further reduce State's ability to effectively monitor manufacturing and distribution agreements.

STATE REQUIRES NO DOCUMENTARY EVIDENCE TO PROVE U.S. PERSON STATUS

Under the Arms Export Control Act, a license to export a munitions item may not be issued to a foreign person (other than a foreign government). State officials told us that they do not require any documentary evidence of U.S. person status to be submitted with export license applications for munitions items. Instead, they rely on the applicants' certifications that the person signing the application is either a U.S. citizen, a permanent resident, or an official of a foreign government entity in the United States. Moreover, State performs spot verifications only when staff notice an unfamiliar signature and these verifications are conducted by telephone. Under these procedures, State does not have reasonable assurance that the persons signing applications are U.S. persons.

We reviewed a sample of 40 approved licenses to see if the applications had been properly certified as required. Seven of the 40 cases did not have the proper certifications for the person signing the application. In another approved case, which was not part of our sample, the person signing the application was, according to his registration with State, a non-U.S. citizen and there was no other evidence that he was a U.S. person.

Our report recommends that State either require documentary proof of U.S. person status in lieu of certification the first time an applicant applies for a license, or conduct random verifications of the U.S. person certifications. State responded that recently introduced application forms should correct the problem of improper certifications. Nevertheless, the new forms do not address the need for documented verifications.

Mr. Chairman, that concludes my statement. I will be pleased to answer any questions that you or other committee members may have.

Attachment I

GAO-IDENTIFIED MISSING NAMES FROM STATE AND COMMERCE WATCHLISTS

Source of derogatory information	Names checked against State watchlist (dated 4/20/93)	Number and percentage of names not found on State watchlist	Names checked against Commerce watchlist dated 1/27/93	Number and percentage of names not found on Commerce watchlist
Department of Justice[a]	92	47 51%	92	69 75%
Treasury's list of designated nationals[b]	184	3 2%	184	33 18%
Intelligence information[c]	45	26 58%	45	26 58%
Department of Commerce[d]	1,120	404 36%	[e]	[e]
Commerce "negative" pre-license checks[f]	39	36 92%	39	11 28%
State "negative" Blue Lantern checks[g]	57	29 51%	57	41 72%
GSA list of excluded parties[h]	298	19 6%	[e]	[e]
Denial orders[i]	291	2 1%	291	17 6%
Total	2,126	566 27%	708	197 28%

[a]Names taken from the Department of Justice's list of significant export control cases for fiscal years 1990, 1991, and 1992 through August 1992. The names include only those parties convicted of violations or listed as fugitives.

[b]Names were based on a GAO judgmental sample from the March 1992 Treasury report on specially designated nationals.

[c]Names of known or suspected diverters or proliferators were provided to GAO by State's Office of Intelligence and Research based on its review of intelligence reports given to the Office of Defense Trade Controls between January and March 1993. Names were checked against a later edition of Commerce's watchlist dated November 1993.

[d]Names are from Commerce's December 1991 Economic Defense List, which includes parties known or suspected of involvement in prohibited activity such as terrorism.

[e]Not applicable. Names from the Economic Defense List were not checked because this list is taken from Commerce's watchlist. Names from GSA's list of excluded parties were not checked because this information is not relevant to Commerce's licensing decisions.

[f]Names were developed by GAO based on a file review of fiscal year 1992 Commerce pre-license checks identified by Commerce as providing derogatory information.

[g]Names were developed by GAO based on a file review of fiscal year 1991 and 1992 State Blue Lantern checks that State identified as producing derogatory information.

[h]Names based on a GAO judgmental sample taken from the September 1992 edition of GSA's Lists of Parties Excluded from Federal Procurement or Nonprocurement Programs.

[i]Names taken from the October 1992 edition of Commerce's report entitled Denial Orders Currently Affecting Export Privileges.

Attachment II

Attachment II

LICENSES ISSUED INVOLVING PARTIES WHOSE NAMES SHOULD HAVE BEEN BUT WERE NOT ON WATCHLISTS (FISCAL YEAR 1990 - AUGUST 1993)

Company	Country	Source of derogatory information	Information first available	Number of licenses issued	Date
Commerce licenses					
A	Singapore	Intelligence	3/93	3	4/93 to 6/93
B	Hong Kong	Intelligence	1/93	1	2/93
Subtotal				4	
State licenses					
C	Pakistan	Intelligence	3/93	1	7/93
D	U.K.	EDL	1/92	1	7/92
E	Trinidad	EDL	1/92	1	8/93
F	Hong Kong	Blue Lantern	10/92	6	10/92 to 4/93
G	India	PLC	5/92	2	4/93 7/93
H	India	PLC	11/92	1	4/93
I	Israel	Intelligence	3/93	7	4/93 to 7/93
J	Israel	Intelligence	3/93	137	4/93 to 8/93
K	Israel	Blue Lantern	2/92	1	5/93
L	Israel	Blue Lantern Intelligence	9/92 3/93	20	10/92 to 7/93
M	Singapore	Intelligence	3/93	39	4/93 to 8/93
N	Denmark	Intelligence	3/93	3	5/93 to 7/93
O	Indonesia	EDL	1/92	1	9/92
Subtotal				220	
Total				224	

Attachment II

Attachment II

Legend

Intelligence -- Names were provided to GAO by State's Office of Intelligence and Research based on its review of intelligence reports given to DTC between January and March 1993.

EDL -- Commerce Department's Economic Defense List issued on 12/31/91.

Blue Lantern -- State Department's program name for pre-licensing or post-shipment checks.

PLC -- Commerce Department pre-licensing checks.

Note: Due to the proprietary nature of information, company names are not disclosed.

Attachment III

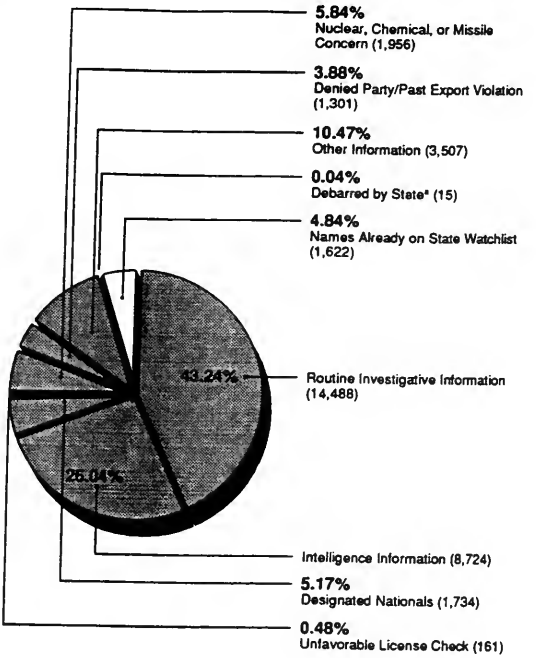
Attachment III

LICENSES INVOLVING WATCHLIST PARTIES
APPROVED WITHOUT BEING SCREENED
BY COMPLIANCE AND ENFORCEMENT PERSONNEL
(FISCAL YEAR 1990 - AUGUST 1993)

Agency	Derogatory watchlist information	Licenses processed	Licenses approved
Commerce	Routine investigative observation	666	622
	Enforcement intelligence	59	47
	Pre-license check performed	56	48
	Nuclear proliferation concern	24	18
	Commerce Economic Defense List	17	16
	Past export control sanction	16	15
	Apartheid supporting party	7	6
	Missile technology control concern	3	2
	East-West equity firm	1	1
	U.S. Customs information	1	1
	Unfavorable pre-license check	1	0
	Subtotal	851	776
State[a]	Missile technology control concern	59	50
	State compliance information	18	16
	Office of the Courts	4	4
	Unfavorable Blue Lantern check	1	1
	Chemical/biological weapon concern	1	0
	Subtotal	83	71
	Totals	934	847

[a]Due to limitations in State's computer system, we examined only a judgmental sample of State licenses. Specifically, we examined licenses involving watchlist parties that were processed in 2 days or less between fiscal year 1990 and August 1993.

Figure IV.1: Commerce Watchlist Entries of Interest to State by Source of Information (as of Aug. 1993)

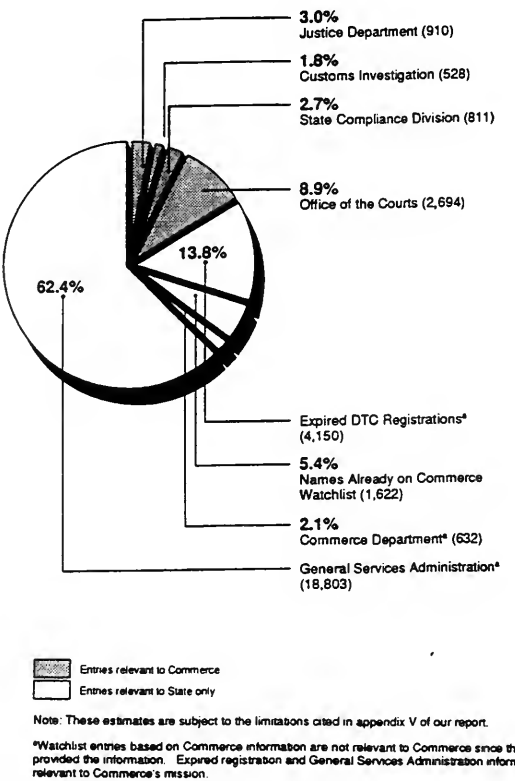


Note: These estimates are subject to the limitations cited in appendix V of our report.

*Since State is the source of this information, State would not benefit from receiving these watchlist entries from Commerce.

Attachment IV

Figure IV.2: State Watchlist Entries of Interest to Commerce By Source of Information (as of Aug. 1993)



Note: These estimates are subject to the limitations cited in appendix V of our report.

[a]Watchlist entries based on Commerce information are not relevant to Commerce since they provided the information. Expired registration and General Services Administration information is not relevant to Commerce's mission.

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United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Federal Services, Post Office and Civil Service, Committee on Governmental Affairs, U.S. Senate

June 1994

EXPORT CONTROLS

License Screening and Compliance Procedures Need Strengthening

GAO/NSIAD-94-178

GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-254478

June 14, 1994

The Honorable David H. Pryor
Chairman, Subcommittee on Federal Services,
Post Office and Civil Service
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

In response to your request, we reviewed export control activities at the Departments of State and Commerce. Specifically, we examined (1) whether these agencies effectively use automated systems to screen license applications, (2) how well these agencies cooperate with each other and the U.S. Customs Service, (3) whether State is monitoring reexports and technology transfers by collecting and reviewing annual sales reports submitted by companies involved in munitions manufacturing or distribution agreements, and (4) how State ensures that munitions licenses are issued only to U.S. persons or foreign governments as required by law.

Background

The U.S. export control system is, in essence, administered by two agencies. Commerce, through its Bureau of Export Administration, licenses sensitive dual-use items (items with both civil and military uses) under the Export Administration Act (EAA); State, through its Office of Defense Trade Controls, licenses munitions items under the Arms Export Control Act (AECA).[1] In addition to export licenses, State's approval is required before a U.S. company is allowed to enter into an agreement with a foreign party involving the manufacture or distribution of munitions items.

Under AECA, all munitions manufacturers or exporters are required to register with State. AECA also requires that licenses not be issued to foreign persons (other than a foreign government). Customs serves as State's enforcement arm for AECA. In contrast, EAA has no registration or U.S. person requirements. Also, EAA specifies how enforcement authority is to be shared between Commerce and Customs, and Commerce, unlike State, has its own enforcement staff.

[1]In addition, the Nuclear Regulatory Commission licenses exports of nuclear reactors. Dual-use nuclear exports are licensed by Commerce in consultation with a number of other agencies.

After a 1987 hearing[2] and our subsequent report,[3] State established an automated license application screening system at the Office of Defense Trade Controls, and Congress amended AECA to authorize State to deny licenses to persons who have been convicted of violating specific statutes enumerated in the AECA. Since 1991, State has maintained an automated watchlist of suspicious organizations and individuals to use when processing export license applications. Commerce has been using an automated watchlist since 1984 to screen its applications.

Watchlist names serve to prompt closer agency review of export license applications. The contents of the watchlists are different, and one of the reasons is that the agencies have different legal requirements for denying export applications. Under AECA, State is required to identify and may deny export licenses to (1) persons who have been indicted or convicted of export violations, foreign corrupt practices, internal security violations, and espionage, and (2) persons who are ineligible to contract with or receive import or export licenses from any U.S. agencies. Under EAA, Commerce may deny export licenses to persons convicted of export violations for up to 10 years from the date of conviction. Both State and Commerce also place on their watchlists parties under U.S. economic sanctions identified by the Treasury Department, parties identified by intelligence sources as suspected or known diverters or proliferators, and those identified from negative pre-licensing or post-shipment checks.

Results in Brief

Both State and Commerce use automated computer systems to screen export applications for ineligible or questionable parties, but they did not include on their watchlists many pertinent individuals and companies. The missing names included those on a Department of Justice list of parties convicted of or listed as fugitives for export violations, parties on whom pre-licensing checks have revealed derogatory information, and parties identified by intelligence reports as known or suspected diverters or proliferators. Consequently, State and Commerce issued licenses to some of these parties without considering the available derogatory information against those parties. Had the information been considered, the licensing decisions may or may not have been different. Additionally, because of procedural and system design deficiencies, the two agencies' screening systems did not identify all the licenses involving watchlist parties.

[2]Senate Governmental Affairs Committee hearing on February 20, 1987, on federal licensing problems for arms exports

[3]Arms Exports Licensing Reviews for Exporting Military Items Can Be Improved (GAO/NSIAD-87-211, Sept 9, 1987)

Furthermore, Commerce has not made the most effective use of intelligence information in its licensing decisions.

While State and Commerce exchange some information regarding export policies and questionable license applications via interagency coordinating committees, cooperation between State and Commerce in the sharing of their watchlists has been limited. The agencies do not routinely share the names on their respective watchlists despite the potential benefits and the agencies' similar export control missions. Consequently, each agency issued licenses to parties that are on the other agency's list without the benefit of the information. While cooperation between State and Customs has been excellent, cooperation between Commerce and Customs has been poor.

State is not monitoring manufacturing and distribution agreements by routinely collecting or reviewing annual sales reports that are required as part of these agreements. State attributed this lack of monitoring to limited staff resources. In addition, State's agreements files are in disarray; many of the files are missing copies of the completed, signed agreements. Without the signed agreements or the annual sales reports, State cannot check for indications of unauthorized sales or transfers.

To fulfill the statutory requirement that no munitions license be issued to a foreign person, State relies strictly on the applicant's certification that the person signing the application is a U.S. person. State does not require documentary evidence and performs only limited telephonic spot checks of the certifications. Additionally, State approved some licenses even though the applications did not have the required certifications.

Weaknesses in License Screening System and Procedures

Agencies' Watchlists Are Not Complete and Current

State and Commerce did not place on their watchlists many parties that, according to their own procedures, should have been included. This failure to capture all of the available derogatory information on suspicious

parties is due to inadequate procedures used to maintain the watchlist databases.

We obtained documents from law enforcement, intelligence, and other agencies used by State and Commerce to update their watchlists and checked to see if the names had in fact been entered onto the agencies' watchlists. We checked 2,126 names that should have been included on the State watchlist and 708 names that should have been included on the Commerce watchlist. Each agency failed to include about 27 percent of the names on their watchlists. More details on the results of this analysis are shown in appendix I.

State and Commerce have inadequate procedures to add names to their watchlists and ensure that data is complete and current. At the time of our review, State did not have formalized procedures for ensuring all pertinent names were entered on the watchlist, including those derived from intelligence information. State also had not designated personnel responsible for entering names from various source documents on a continuing basis. As a result, responsibility for adding and reviewing names was not well-defined and was diffused among the staff. One State official attributed the inadequate procedures to a lack of staff resources. He told us that much of the data entry was done by part-time personnel who also have other administrative duties and that State's watchlist was built with a "catch as catch can" approach. In fact, State requested but did not receive dedicated data entry personnel in its financial plans for fiscal years 1993 and 1994. However, State informed us that, as a result of our review, it has assigned to a specific compliance division employee the responsibility for monitoring the watchlist and ensuring receipt of other agencies' information that is produced at regular intervals. We did not verify or evaluate the effectiveness of this action.

Commerce also does not have formalized procedures for controlling what information should be entered on its watchlist and by whom. Information can be added to the watchlist by staff from the Office of Enforcement Support or by Office of Export Enforcement headquarters personnel and agents in the field. However, while many people in Commerce can add names to the list, no one is directly responsible for ensuring that relevant information is in fact entered. For example, no one is responsible for obtaining and reviewing information from State's Blue Lantern inspection program.[4] Responsibility for entering names from the Department of Justice's periodic report of significant export control violation cases was

[4]Blue Lantern is the program name for State's pre-licensing or post-shipment checks.

only recently assigned. While Commerce staff routinely review intelligence reports distributed to its Office of Intelligence Liaison, these reviews are not documented, and there is no written guidance on what information and names should be pulled from these reports for inclusion on Commerce's watchlist.

Because State and Commerce did not capture all the relevant names on their watchlists, they issued many licenses to parties without considering derogatory information regarding them. Had the information been available, these licenses may or may not have been approved.

Our search of State's and Commerce's licensing databases covering the period fiscal year 1990 to August 1993 showed that the agencies had issued 224 licenses to 15 parties whose names should have been but were not on the agencies' watchlists. Of the 224 licenses, Commerce issued 4 licenses to 2 parties while State issued 220 licenses to 13 parties. For example:

- A State Blue Lantern inspection revealed in January 1992 that an Israeli company was selling F-16 parts without U.S. authorization, but the name of this company was never placed on State's watchlist. In May 1993, State issued a license for exports involving this company.
- A company in Indonesia was listed in a December 1991 Commerce document as a subject of an unfavorable pre-licensing or post-shipment check. State used this document as one of the sources for its watchlist. However, State did not put this company on its watchlist until November 1992, 11 months after the information first became available. In the meantime, State issued a license in September 1992 for exports involving this company without knowledge of the unfavorable information regarding the company.

Appendix II contains more details on the 224 cases.

Agencies' Screening Systems Do Not Always Capture Applications With Watchlist Names

Between fiscal year 1990 and August 1993, Commerce and State approved 847 licenses involving parties who were on their watchlists without first considering derogatory information contained in their own watchlists (see app. III). Had the information been considered, the licensing decisions may or may not have been different.

Commerce uses a sophisticated computer name-matching program to assign identification numbers to all exporters and consignees in its database. The identification numbers of those exporters and consignees

that are on Commerce's watchlist are flagged by the computer. When a license application is processed, the computer systematically compares the identification numbers on the application to the identification numbers of the parties on its watchlist. When a match is made the system automatically sends the application to the enforcement staff for review.[5] Also, the name is flagged on the licensing officer's computer screen to prevent the license from being issued until the flag has been removed by the enforcement staff.

Commerce, however, has not ensured that each party is given only one identification number and has in some cases assigned multiple identification numbers to the same party. Some of these identification numbers have watchlist flags on them, while others do not. Consequently, license applications involving parties on the watchlist may not always be caught because the parties may be assigned identification numbers that do not carry watchlist flags. Commerce noted in its comments that, in the fall of 1992, it had initiated an effort to eliminate multiple identification numbers. However, our analysis of the Commerce data shows this effort has not solved the problem.

State's system for identifying watchlist parties on license applications uses a limited computer name-matching program that has difficulty finding matches when there is slight variation on how names are entered into the system or when there is a minor data entry error. Further, unlike Commerce, State has a largely manual screening system. When a name on a license application matches a watchlist party, unless it is the name of the applicant, State's computer system does not automatically flag the application for the licensing officer or send the case to the Compliance Division. For example, if the application is to export to a questionable end user, the case would not automatically be flagged. Instead, Compliance Division personnel must manually review a computer matching report to identify matches and refer the cases to compliance specialists for further investigation. Moreover, unlike Commerce's system, State's system does not prevent a license from being issued until compliance staff have completed their review. State's system also does not automatically track whether a compliance officer examined the case, length of the review, or what actions resulted from the review. Consequently, there is no documentation to determine which cases were caught by the screening system or processed without review by compliance staff.

[5]Enforcement staff are responsible for reviewing the applications and considering the information included on the screened party and then making appropriate recommendations to the licensing officer.

Between fiscal year 1990 and August 1993, Commerce processed 851 license applications involving 179 different parties on its watchlist without sending these applications to its enforcement staff for review. While 75 of these applications were eventually denied or returned without action through the licensing review process, 776 were approved. Commerce had placed these parties on its watchlist based on nuclear weapons proliferation concerns, missile technology control concerns, unfavorable pre-license checks, or derogatory enforcement intelligence information. For example, the following licenses were not caught by Commerce's screening system and not reviewed by enforcement staff:

- Commerce issued two licenses involving a company placed on its watchlist in 1986 for nuclear proliferation reasons.
- Commerce issued 15 licenses involving a company placed on its watchlist in 1991 for past export control sanctions.

In a sample of 86 State licenses,[6] State processed 83 license applications involving 28 companies on its watchlist without these applications being reviewed by compliance staff.[7] Officials at State said that their compliance specialists reviewed 3 of the 86 licenses. They also stated that they might have reviewed some of the remaining 83 licenses, but there was no record, computerized or manual, to support this statement, and they acknowledged it was unlikely because these licenses were approved in 2 days or less. While 12 of these licenses were eventually denied or returned without action through the licensing review process, 71 were approved. These parties were placed on State's watchlist for missile technology control concerns, chemical and biological weapon concerns, and compliance concerns. For example, State issued 3 licenses involving a company placed on its watchlist in 1991 for missile technology control concerns.

During the course of our work, we also found that in 1992 State issued four licenses involving a company recently convicted of illegally selling aircraft parts to Iran even though in 1991 State had debarred the company from future export licenses and had included the company on its watchlist.

[6]Due to limitations in State's computer system, we examined only a judgmental sample of State licenses. Specifically, we examined applications involving watchlist parties that were processed in 2 days or less between fiscal year 1990 and August 1993.

[7]State compliance staff, like Commerce enforcement staff, are responsible for reviewing derogatory watchlist information and making recommendations to licensing officers.

Commerce Has Not Made the Most Effective Use of Intelligence Information to Screen Licenses

Unlike State, Commerce does not deny an export application solely on the basis of derogatory intelligence information in its watchlist. Commerce approved 49 licenses after its pre-license checks failed to corroborate the negative intelligence information involving the parties on the applications. Commerce officials said they cannot deny a license based on intelligence information unless it is corroborated by a negative pre-license check or other information. However, recent GAO and Inspector General reports have noted limitations and recommended improvements in Commerce's pre-licensing check program.[8]

Under AECA, State has broad authority to deny an application on national security or foreign policy grounds without having to provide a detailed explanation. Commerce, however, is required under EAA to provide the applicant a more detailed explanation, consistent with national security and foreign policy, as to why an application is denied. Because of this requirement, the intelligence agencies do not want Commerce to deny licenses solely on the basis of intelligence information for fear that such denials may compromise their sources or collection methodologies.

Under the current procedure, Commerce enforcement agents use intelligence information as a lead to develop collateral information that can be used to deny a license. When the name of a party on a license application is identified through the screening process as a potential diverter or proliferator based on information from intelligence sources, Commerce may request a pre-licensing check on the party. If the check produces derogatory information, Commerce can use that as the basis for denying the license. Otherwise, the intelligence information alone does not get used to deny the license. Commerce does not routinely refer such cases to the intelligence sources to (1) assess the merits of the intelligence information and (2) determine whether the information could be sanitized to permit its use in denying a license application. Commerce and intelligence officials estimated that over the last 5 years, Commerce had consulted with intelligence sources on only about three such cases.

For fiscal years 1990 to 1993, we found 49 licenses that had names on the Commerce watchlist based on intelligence information and that Commerce approved after a pre-license check failed to corroborate the negative information in the intelligence report. While Commerce's current procedure is designed to accommodate the concerns of the intelligence

[8]Nuclear Non-Proliferation: Export Licensing Procedures for Dual-Use Items Need to Be Strengthened (GAO/NSIAD-94-119, Apr. 26, 1994) and The Federal Government's Export Licensing Processes for Munitions and Dual-Use Commodities (Joint State/Commerce/DOD/Energy Inspector General Report, Sept. 1993).

agencies, it also limits the effective use of available intelligence information for licensing purposes. For example, during the same period, we found only two applications involving parties flagged based on intelligence information that Commerce denied or returned because a pre-license check produced unfavorable results.

Cooperation Among Commerce, Customs, and State

State and Commerce Do Not Share Their Watchlists

While State and Commerce exchange some information regarding export policies and questionable license applications via interagency coordinating committees, they do not routinely share information from their watchlists with each other. Some entries on each agency's watchlist are of unique interest only to that agency. However, thousands of names on the watchlists are of interest to both Commerce and State but, because the watchlists are not shared, are not being used to screen export applications. In fact, each agency has processed licenses involving relevant parties on the watchlist of the other agency.

Each agency's watchlist includes many entries dealing with compliance problems, intelligence reports, reports provided by the Justice Department and Customs agents, pre-license or post-shipment checks, and other issues directly relevant to the missions of both agencies. Commerce's watchlist has about 33,000 entries while State's watchlist has about 30,000 entries. Many of the entries on both lists are duplicates of the same name (for example, Commerce may list a name separately for each different company address). While both agencies are generally concerned or interested in many of the same types of parties (that is, front companies, suspected diverters, and parties indicted or convicted of export violations), some watchlist entries are of interest only to one agency.[9] (See app. IV for the composition of each agency's watchlist and information of interest to the other agency.)

We compared State's and Commerce's watchlists to determine how many entries of interest to both agencies are not being used by both agencies to

[9]For example, names listed on State's watchlist because they are on General Services Administration's (GSA) list of parties excluded from federal contracts (over 60 percent of State's watchlist) would not be relevant to Commerce's licensing decisions.

screen applications. About 5,000 entries on the State watchlist of interest to Commerce were not on Commerce's watchlist. Similarly, about 32,000 entries on the Commerce list of interest to State were not on State's watchlist. These entries represent derogatory information that State and Commerce are not using in their licensing reviews. The actual numbers of unique names of interest to each agency, however, are smaller than our estimates due to duplicate entries and other limitations cited in app. V. Nevertheless, our approach provides a valid indication of the problems we cite in this area.

State officials noted that they recognize the utility of sharing each other's watchlist with Commerce, and the agencies have held discussions to this end. Commerce officials stated that the two agencies discussed sharing information 3 years ago, but nothing came of these discussions.

Each agency has processed licenses involving parties on the watchlist of the other agency. We estimate State processed about 6,700 licenses involving about 300 relevant parties on Commerce's watchlist that were not on State's watchlist. State approved about 6,100 of these licenses.[10] Similarly, Commerce processed 17 licenses involving 3 parties on State's watchlist that were not on Commerce's watchlist and approved 9 of these licenses.[11]

These State and Commerce licensing decisions were made without considering the derogatory information in the other agency's possession because the agencies do not routinely share their watchlists.[12] The derogatory information not used in these licensing decisions included parties listed for enforcement intelligence, unfavorable post-shipment checks, and nuclear proliferation and missile technology concerns. Had the derogatory information been considered, the agencies might have requested pre-licensing checks, denied the licenses, or approved them with conditions.

[10]These estimates are subject to limitations cited in app. V.

[11]We verified the names of the 3 parties and the disposition of the 17 Commerce licenses.

[12]Commerce does provide State a copy of its Economic Defense List. However, this list includes only some of the entries from Commerce's watchlist and is published just once a year.

Cooperation Between State and Customs Contrasts Sharply With That Between Commerce and Customs

On the basis of interviews with State and Customs officials and our observations, cooperation between the two agencies is excellent. Customs screens State's registration applications for law enforcement concerns, and State uses the results for input into its watchlist. Customs has also given State access to its enforcement database. State, in return, has given Customs access to its licensing database for use by Customs officers at the ports throughout the United States. In addition, Customs has liaison personnel on detail at State to facilitate and coordinate case investigations and other Customs enforcement actions.

In contrast, cooperation between Commerce and Customs has been poor. As we recently reported,[13] over the past several years, the agencies have engaged in ongoing disputes over their overlapping jurisdiction in enforcing dual-use export controls. They have significantly disagreed in, among other things, the area of sharing of licensing data. From the early 1980s, Customs had attempted to gain full access to Commerce licensing data to aid its inspections and investigations. Commerce, however, was reluctant to extend full access to Customs because of cost, time, and security concerns. Despite 1985 legislation that mandates the sharing of information and subsequent negotiations between the agencies in January 1992, Commerce did not agree until September 1993 to give Customs licensing data. However, Commerce noted in its comments that the poor cooperation ended with the September 1993 memorandum of understanding and agreements between Commerce and Customs. While this represents a significant step towards a cooperative relationship, we have not verified that real progress has been achieved.

State Is Not Routinely Collecting or Reviewing Annual Sales Reports

State requires the U.S. company or its licensee to submit annual sales reports when entering into a manufacturing or distribution agreement involving defense articles.[14] The reports are to include information on sales or other transfers of the licensed articles, by quantity, type, dollar value, and purchaser or recipient. However, State officials noted that due to limited staff, they have not routinely collected or reviewed these reports.

We selected a sample of 18 approved agreements to see whether the annual sales reports had been submitted, as required, and whether State

[13]Export Controls: Actions Needed to Improve Enforcement (GAO/NSIAD-94-28, Dec. 30, 1993)

[14]Unlike routine export licenses, distribution and manufacturing agreements cover the export of large volumes of defense articles for distribution from a foreign country or the manufacture of defense articles in a foreign country.

had reviewed them. In 6 of the 18 cases, State did not have copies of the final agreements or documentation indicating that the agreements were ever concluded. Companies are required to inform State within 60 days if a decision is made not to conclude an agreement. In 14 of the 18 cases where we determined that annual reports should have been filed, annual reports were not on file in 13 cases. State subsequently received annual reports for six of the cases by contacting the companies at our request.

Additionally, State officials acknowledged that the agreement files were in such disarray that they could not distinguish between those companies that failed to submit the reports and those that did submit the reports but whose reports may have been misplaced. They attributed the poor management of the files to a lack of staff and a move of their document storage facility a few years ago. We noted that, notwithstanding limited resources, State had not assigned oversight responsibility for the agreements among the staff. State is now attempting to bring the files up-to-date by contacting companies to determine what records are missing from the files. Without the signed agreements or the annual sales reports, State cannot check for indications of unauthorized sales or transfers.[15]

State informed us that, in an effort to achieve the same compliance goals with fewer resources, it is considering a system whereby companies would certify that they were maintaining these records and would be subject to sanctions if they fail to do so. We believe this would further reduce State's ability to effectively monitor the arrangements.

State Does Not Require Documentary Evidence to Prove U.S. Person Status

State officials told us that they do not require any documentary evidence of U.S. person status to be submitted with export license applications for munitions items. Instead, they rely on the applicants' certifications that the persons signing the applications are U.S. persons. Moreover, State told us it performs verification only when staff notice unfamiliar signatures on the applications, and then verification is usually done by telephone. Under these procedures, State does not have reasonable assurances that the persons signing applications are U.S. persons.

Under AECA, a license to export a munitions item may not be issued to a foreign person (other than a foreign government). State's implementing regulation requires that an official empowered by the applicant certify that

[15]In December 1993, State reported that, despite major improvements in its management of defense trade, material weaknesses still exist in overseas posts' implementation of the process used for end-use checks used to verify compliance with AECA. State acknowledged that as a result it did not have reasonable assurances that defense exports were not being diverted to unauthorized uses.

the person signing the application (1) is a citizen or national of the United States; (2) has been lawfully admitted to the United States for permanent residence under the Immigration and Nationality Act, as amended; or (3) is an official of a foreign government entity in the United States. State officials explained that the significance of this requirement is that if an export violation associated with the license is detected, the government could more easily prosecute a U.S. person than a foreign person.

Seven of 40 approved cases we sampled did not contain the proper certification. In six of the seven cases, a company official signing the transmittal letter certified that he/she was a U.S. person, but there was no certification that the person (a different official) signing the application was a U.S. person. In the remaining case, there was no certification of any kind. In another approved case, which was not part of our sample, the person signing the application was, according to his registration with State, a non-U.S. citizen, and there was no other evidence that he was a U.S. person. State informed us that recently introduced application forms should correct the improper certification problem. Nevertheless, the new forms do not address the need for documented verifications.

Recommendations

We recommend that the Secretary of State direct the Office of Defense Trade Controls to take the following actions:

- Formally assign watchlist data-entry responsibilities among staff and establish procedures and guidance to ensure data entries are complete and up-to-date.
- Share the relevant portion of State's watchlist with Commerce on a regular basis and incorporate the relevant portion of Commerce's watchlist into State's watchlist.
- Redesign State's screening system to (1) create an automated license tracking system that will document compliance division review for licenses involving watchlist parties, (2) automatically inform the licensing division if any party on a license is on the watchlist, and (3) prevent a license from being issued until compliance staff have completed their review.
- Assign oversight and monitoring responsibilities for the manufacturing and distribution agreements among the staff and ensure that the files on these agreements are updated.
- Either require documentary proof instead of a certification of U.S. person status the first time an applicant applies for a license, or randomly verify with documentation the applicants' certifications of U.S. person status.

We recommend that the Secretary of Commerce direct the Bureau of Export Administration to take the following actions:

- Formally assign watchlist data-entry responsibilities among the staff and establish procedures and guidance to ensure data entries are complete and up-to-date.
- Share the relevant portion of Commerce's watchlist with State on a regular basis and incorporate the relevant portion of State's watchlist into Commerce's watchlist.
- Establish and implement adequate procedures to ensure that multiple identification numbers are not assigned to the same party and eliminate existing multiple identification numbers from the system.
- When pre-licensing checks are conducted because of information from intelligence sources but result in no derogatory information, routinely consult with the intelligence sources to (1) assess the merits of the intelligence information and (2) determine whether the information could be sanitized to permit its use in denying a license application.

Agency Comments and Our Evaluation

We obtained written comments from the Departments of Commerce and State and the U.S. Customs Service on a draft of this report (see app. VI, VII, and VIII). Commerce indicated that our recommendations merit serious consideration but indicated that the intelligence community should not make final licensing decisions. We clarified the recommendation to better reflect the desired actions.

State generally agreed with the analyses and recommendations in the report. State expressed concern, however, that the draft report gave the impression that, when licenses were issued to parties on another agency's watchlist or to parties missing from a watchlist, those licenses should not have been issued. We revised the report where appropriate to further emphasize that decisions on those licenses may or may not have been different if the watchlist information had been available.

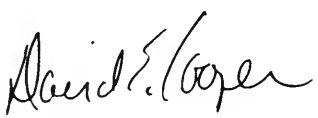
Customs commented that the sharing of watchlists between State and Commerce should enhance export enforcement.

Our work was performed from October 1992 to June 1994 in accordance with generally accepted government auditing standards. The scope and methodology for our review is discussed in appendix V.

Unless you publicly disclose the contents of this report earlier, we plan no further distribution of this report until 5 days from its issue date. At that time we will send copies of this report to other congressional committees, the Secretaries of State and Commerce, and the Commissioner of Customs. We will also make copies available to other interested parties upon request.

Please contact me at 202-512-4587 if you or your staff should have any questions concerning this report. Major contributors to this report are James F. Wiggins, Davi M. D'Agostino, John P. Ting, David C. Trimble, and Jai Eun Lee.

Sincerely yours,



David E. Cooper
Director, Acquisition Policy, Technology,
and Competitiveness Issues

Contents

Figures

Abbreviations

AECA	Arms Export Control Act
EAA	Export Administration Act
GSA	General Services Administration

Appendix I

GAO-Identified Missing Names From State and Commerce Watchlists

Source of derogatory information	Names checked against State watchlist (dated 4/20/93)	Number and percentage of names not found on State watchlist	Names checked against Commerce watchlist dated 1/27/93	Number and percentage of names not found on Commerce watchlist
Department of Justice[a]	92	47 51%	92	69 75%
Treasury's list of designated nationals[b]	184	3 2%	184	33 18%
Intelligence information[c]	45	26 58%	45	26 58%
Department of Commerce[d]	1,120	404 36%	*	*
Commerce "negative" pre-license checks[e]	39	36 92%	39	11 28%
State "negative" Blue Lantern checks[g]	57	29 51%	57	41 72%
GSA list of excluded parties[h]	298	19 6%	*	*
Denial orders[i]	291	2 1%	291	17 6%
Total	2,126	566 27%	708	197 28%

[a]Names taken from the Department of Justice's list of significant export control cases for fiscal years 1990, 1991, and 1992 through August 1992. The names include only those parties convicted of violations or listed as fugitives

[b]Names were based on a GAO judgmental sample from the March 1992 Treasury report on specially designated nationals

[c]Names of known or suspected diverters or proliferators were provided to GAO by State's Office of Intelligence and Research based on its review of intelligence reports given to the Office of Defense Trade Controls between January and March 1993. Names were checked against a later edition of Commerce's watchlist dated November 1993

[d]Names are from Commerce's December 1991 Economic Defense List, which includes parties known or suspected of involvement in prohibited activity such as terrorism

[*]Not applicable. Names from the Economic Defense List were not checked because this list is taken from Commerce's watchlist. Names from GSA's list of excluded parties were not checked because this information is not relevant to Commerce's licensing decisions

[e]Names were developed by GAO based on a file review of fiscal year 1992 Commerce pre-license checks identified by Commerce as providing derogatory information

[g]Names were developed by GAO based on a file review of fiscal year 1991 and 1992 State Blue Lantern checks that State identified as producing derogatory information

[h]Names based on a GAO judgmental sample taken from the September 1992 edition of GSA's Lists of Parties Excluded from Federal Procurement or Nonprocurement Programs

[i]Names taken from the October 1992 edition of Commerce's report entitled Denial Orders Currently Affecting Export Privileges

Appendix II

Licenses Issued Involving Parties Whose Names Should Have Been but Were Not on Watchlists (Fiscal Year 1990 - August 1993)

Company	Country	Source of derogatory information	Information first available	Number of licenses issued	Date
Commerce licenses					
A	Singapore	Intelligence	3/93	3	4/93 to 6/93
B	Hong Kong	Intelligence	1/93	1	2/93
Subtotal				**4**	
State licenses					
C	Pakistan	Intelligence	3/93	1	7/93
D	U.K.	EDL	1/92	1	7/92
E	Trinidad	EDL	1/92	1	8/93
F	Hong Kong	Blue Lantern	10/92	6	10/92 to 4/93
G	India	PLC	5/92	2	4/93 7/93
H	India	PLC	11/92	1	4/93
I	Israel	Intelligence	3/93	7	4/93 to 7/93
J	Israel	Intelligence	3/93	137	4/93 to 8/93
K	Israel	Blue Lantern	2/92	1	5/93
L	Israel	Blue Lantern Intelligence	9/92 3/93	20	10/92 to 7/93
M	Singapore	Intelligence	3/93	39	4/93 to 8/93
N	Denmark	Intelligence	3/93	3	5/93 to 7/93
O	Indonesia	EDL	1/92	1	9/92
Subtotal				**220**	
Total				**224**	

Legend

Intelligence — Names were provided to GAO by State's Office of Intelligence and Research based on its review of intelligence reports given to the Office of Defense Trade Controls between January and March 1993.

EDL — Commerce Department's Economic Defense List issued on 12/31/91

Blue Lantern — State Department's program name for pre-licensing or post-shipment checks

PLC — Commerce Department pre-licensing checks

Note: Due to the proprietary nature of information, company names are not disclosed

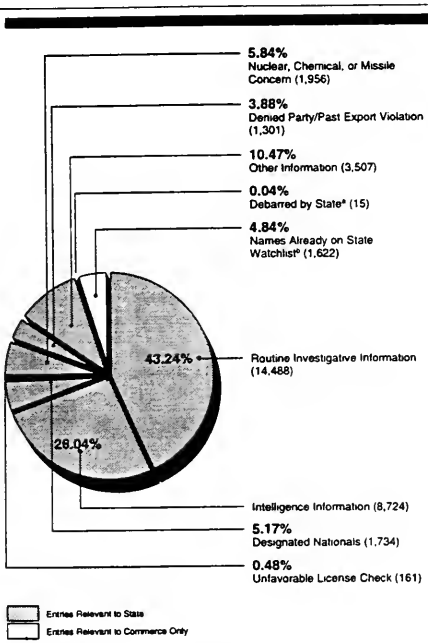
Licenses Involving Watchlist Parties Approved Without Being Screened by Compliance and Enforcement Personnel (Fiscal Year 1990 - August 1993)

Agency	Derogatory watchlist information	Licenses processed	Licenses approved
Commerce	Routine investigative observation	666	622
	Enforcement intelligence	59	47
	Pre-license check performed	56	48
	Nuclear proliferation concern	24	18
	Commerce Economic Defense List	17	16
	Past export control sanction	16	15
	Apartheid supporting party	7	6
	Missile technology control concern	3	2
	East-West equity firm	1	1
	U.S. Customs information	1	1
	Unfavorable pre-license check	1	0
Subtotal		**851**	**776**
State[a]	Missile technology control concern	59	50
	State compliance information	18	16
	Office of the Courts	4	4
	Unfavorable Blue Lantern check	1	1
	Chemical/biological weapon concern	1	0
Subtotal		**83**	**71**
Total		**934**	**847**

[a]Due to limitations in State's computer system, we examined only a judgmental sample of State licenses. Specifically, we examined licenses involving watchlist parties that were processed in 2 days or less between fiscal year 1990 and August 1993.

State and Commerce Watchlist Entries of Mutual Interest (as of Aug. 1993)

Figure IV.1: Commerce Watchlist Entries of Interest to State by Source of Information

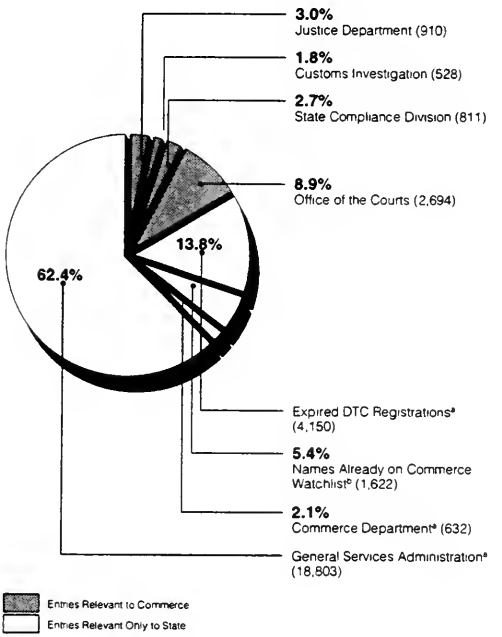


Note These estimates are subject to limitations cited in appendix V

*Parties listed as debarred by State are not relevant to State Since State is the source of this information, State would not benefit from receiving these watchlist entries from Commerce

*The number of entries also on the State watchlist is larger due to the same names being entered multiple times

Figure IV.2: State Watchlist Entries of Interest to Commerce by Source of Information



Note These estimates are subject to limitations cited in appendix V

[a]Watchlist entries based on Commerce information are not relevant to Commerce since they provided the information Expired Registration and General Services Administration information is not relevant to Commerce's mission

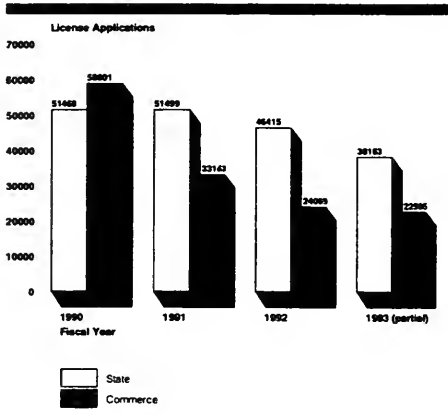
[b]The number of entries also on the Commerce watchlist is actually larger due to the same names being entered multiple times

Appendix V

Scope and Methodology

To perform the name matching and license searches of State and Commerce watchlist and license files, we obtained these records on computer tapes from State and Commerce. The licensing records covered the period from fiscal year 1990 through August 1993.

Figure V.1: State and Commerce Licenses by Year



We chose to work with the most recent four fiscal years because (1) this period provided a sufficiently large volume of licenses for analysis, (2) this period was the most relevant to current operations at State and Commerce, and (3) State did not have an automated watchlist screening system prior to 1991.

To determine the reliability of the data, we assessed the relevant and general application controls for Commerce and State's systems and found them to be generally adequate. We also conducted sufficient tests of the data. Commerce reported that since fiscal year 1988, data entry reliability has approached 100 percent with the addition of electronic license

application filing and optical character reader technology. We did not systematically sample licensing records to test data accuracy but did verify specific cases throughout the course of our review. We concluded on the basis of these tests and assessments that the data was sufficiently reliable to be used in meeting the assignment's objectives.

To determine whether the agencies effectively use automated systems to screen license applications, we interviewed State and Commerce officials to obtain an understanding of how their automated watchlists are compiled and used. We then obtained some of the documents used by State and Commerce to compile their watchlists and conducted checks to see if the names from those sources had in fact been entered onto the watchlists. For those names that the agencies failed to capture on their watchlists, we checked the agencies' licensing records to see if any licenses had been issued involving such parties after they had been listed in the source documents. To see how well the agencies' screening processes work, we searched each agency's licensing records for parties listed on the watchlist to see if any licenses were issued without being caught by the screening procedures and reviewed by compliance or enforcement personnel. We also discussed with State, Commerce, and intelligence officials whether and how intelligence information is used to screen license applications.

To ascertain how well State and Commerce cooperate with each other and with the U.S. Customs Service, we examined how well the agencies share enforcement information with one another and held discussions with State, Commerce, and Customs officials to see what type of information they were or were not sharing.

To assess the extent of information not shared between State and Commerce, we compared the State and Commerce watchlists to identify names unique to each agency's watchlist but of interest to the other agency. To assess the benefits of increased information sharing, we searched the agencies' licensing records to see if licenses were issued by one agency when the other agency possessed derogatory information about a party to the license. Specifically, we identified entries of interest (e.g., nuclear proliferation controls) to the other agency using the reason codes describing why the entries were placed on the watchlist. Because the Commerce and State watchlists include over 60,000 entries, many of which are duplicate entries or repeat a name with a slightly different spelling, we used a 10-character name-matching program to determine the number of entries unique and common to both watchlists. We manually

reviewed all the potential matches identified through this program to remove any non-matches.

This approach has inherent limitations. First, Commerce and State watchlists have multiple entries for the same party which makes estimating the true number of unique and common entries difficult. Second, the use of a 10-character computer matching program is affected by variations and errors in how names are entered in the agencies' watchlists. These limitations are likely to result in estimates which overstate (1) the number of entries on one agency's watchlist which are of interest to the other; (2) the number of entries on one list but missing from the other; and (3) the number of licenses issued by State to parties on Commerce's watchlist which were missing from State's list. The limitations are further likely to result in an understated estimate of the common names on the two agencies' watchlists. Nevertheless, our methodology provides a valid indication of the problems we cite in the report. The precise number of entries that are relevant to each agency cannot be determined until the agencies actually share their watchlists.

We visited Customs headquarters to see how Customs screens registrations for State. We also visited a Customs field office to corroborate that State is giving Customs officials at the ports access to its licensing data. We interviewed Customs, State, and Commerce officials concerning relations among the agencies. However, we relied primarily on our December 1993 report to document Customs' difficulties in gaining access to Commerce's licensing data.[1]

To determine whether State was collecting and reviewing annual sales reports required of the manufacturing or distribution agreements, we interviewed State officials to gain an understanding of reporting requirements and filing and review procedures. We selected a sample of 18 approved agreement cases to see if the reports were being submitted as required and what reviews State had made of them. Because many of the files we selected were missing documents, State officials contacted the companies to try to obtain the missing documents, but their effort was only partially successful.

To determine how State ensures that munitions licenses are issued only to U.S. persons, we met with State officials to gain an understanding of the purpose of the requirement and how State ensures the requirement is satisfied by the applicants. We then selected a sample of 40 approved

[1]Export Controls: Actions Needed to Improve Enforcement (GAO/NSIAD-94-28, Dec. 30, 1993)

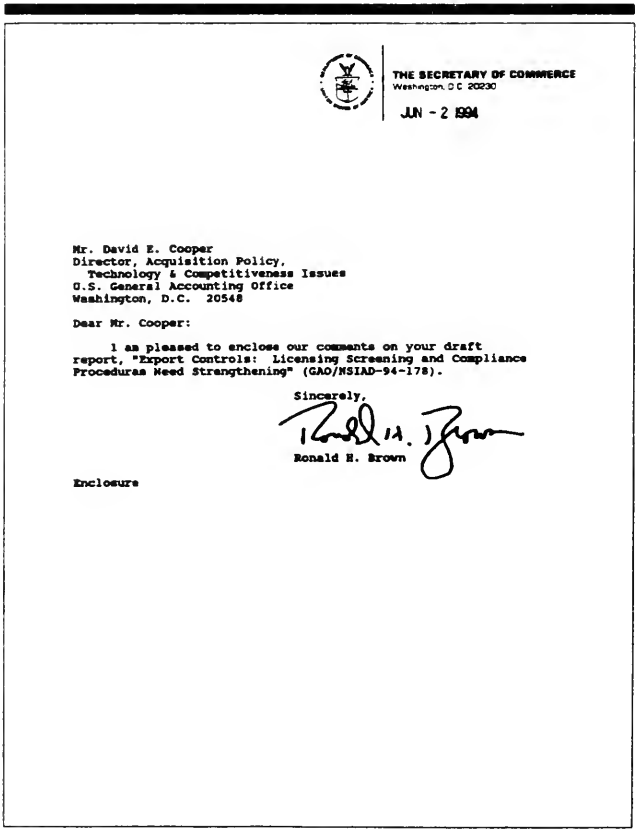
licenses to see if the applicants had made the certifications required by State.

The samples of agreement files we selected for review and the sample of approved licenses we selected for determining whether they were issued to U.S. persons were not statistical samples and are therefore not projectable.

Appendix VI

Comments From the Department of Commerce

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



THE SECRETARY OF COMMERCE
Washington, D.C. 20230

JUN - 2 1994

Mr. David E. Cooper
Director, Acquisition Policy,
Technology & Competitiveness Issues
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Cooper:

I am pleased to enclose our comments on your draft report, "Export Controls: Licensing Screening and Compliance Procedures Need Strengthening" (GAO/NSIAD-94-178).

Sincerely,

Ronald H. Brown

Enclosure

ENCLOSURE

U.S. DEPARTMENT OF COMMERCE

COMMENTS ON GAO DRAFT REPORT ENTITLED

"EXPORT CONTROLS: License Screening and

Compliance Procedures Need Strengthening"

GAO/NSIAD 94-178

SUMMARY

Notwithstanding our concerns about a number of points in the draft study, which are detailed below, we believe that its recommendations merit serious consideration.

COMMENTS ON DRAFT STUDY:

Now on p. 2.

On page 3, under Results in Brief, there are several items mistakenly attributed to Commerce. In the second sentence, the words "..indicted or.." should be replaced with "listed as fugitives" to make this information consistent with footnote A of Appendix I. Also, in this same sentence the words "...-or post-.." should also be deleted as footnote F of Appendix I indicates no post-shipment checks were included. Finally, in this same sentence, the phrase "...and parties identified by intelligence reports as known or suspected weapons proliferators" should also be deleted as BXA is not privy to these reports.

See comment 1

Now on pp. 3 and 8.

On page 4 and also top of page 12, the report states that Commerce cannot deny an export application solely on the basis of derogatory intelligence information. This was told to GAO during discussions with Office of Enforcement Support (OES) personnel. Based on OES's access to original source intelligence through its Memorandum of Understanding with several different agencies, it cannot use this original intelligence information as the basis for denial of an export license application. In cases where derogatory information is based on such intelligence, OES attempts to corroborate it and develop an unclassified information source through other available means, such as completing a pre-license check (PLC) or researching other open sources of information. However, in certain circumstances, the Office of Export Licensing (OEL) may use sanitized versions of intelligence information as the basis for denial. In all cases where intelligence information is used as the basis to deny an export license application, Commerce thoroughly coordinates with the originator of the information in order to preclude the compromise of sensitive intelligence sources and methods.

See p. 8

See comment 2

Now on p. 3

In the first paragraph at the top of page 4, the following sentence should be deleted or revised. "Furthermore, Commerce issued licenses even when parties of concern identified by intelligence sources were flagged by its screening system." This sentence is misleading because it implies all applications involving screened parties should be denied. The screen includes information from a variety of sources, and this information varies in its specificity and detail. There is not a direct causal relationship between screened parties and license

See comment 3

rejections. In all cases when there is a screen match pertaining to intelligence information, this information is considered against other facts included on the export application and the current licensing policies in place for the involved commodities and country destination. After BXA considers all information surrounding that particular export transaction (intelligence information, pre-license or post-shipment check information, investigative information, other background information, interagency comments, licensing policy issues, etc.), then the appropriate licensing decision is made.

See p. 11

In the last sentence of the second paragraph of page four, the report states that "...cooperation between Commerce and Customs has been poor." We believe that the Memorandum of Understanding and Agreement signed in September, 1993 provides the basis for effective cooperation and sharing of information between the two agencies, and, in fact, has achieved that result.

Now on p. 4

The first sentence of the last paragraph on page six states that Commerce does not have formalized procedures for controlling what information should be entered on its watchlist and by whom. In fact, we do have formalized procedures for all of the items on this list including the Department of Justice (DOJ) list. This DOJ list was formally assigned in October, 1993. In addition, we wrote to Justice on October 25, 1993 and stressed the importance of receiving continual updates to this list and immediate notification of any convictions as they occur. Justice replied on November 2, 1993, and agreed to the procedures set forth in our letter regarding notifications. It is also important to note that there are formal procedures that have existed since the beginning of Commerce's automated screening system that include standards for screening parties. These procedures can be found today in Section 12 of the Special Agent's Manual, dated October 3, 1989. Also, BXA's Office of Information Resource Management (OIRM) produced and distributed specific guidance for all Export Enforcement personnel regarding how to add, delete, or change an entry on the automated screen in Section 7 of its March, 1992, publication, Using the ENFORCE System.

See p. 5.

See comment 4.

Now on p. 4.
See comment 1.

In the second sentence of the last paragraph of page six, the report inaccurately states who may update BXA's watchlist. It should read that staff from the Office of Enforcement Support, and Office of Export Enforcement field agents and headquarters personnel may update BXA's watchlist.

See comment 5.

In several places in the report, there are references to licenses issued to parties that should have been on the watchlist or names of parties missing from our watchlist. GAO specifically refused to supply us with the entire list of 197 parties allegedly missing from our watchlist and agreed to supply us only with a sample of 10 instead. We hereby formally request all of this

data so that we might review it in detail and provide additional information regarding our actions in these cases. The specific references in the report are:

o The last sentance of the third paragraph on page seven states that Commerce issued four licenses to parties who should have been on its watchlist.

o At the first inset point made at the bottom of page 10, the report states that Commerce issued two licenses involving a party on its watchlist in 1986 for nuclear proliferation reasons.

o At the top of page 11, the report states that Commerce issued 15 licenses involving a company on its watchlist in 1991.

o At the top of page 16, there is a statement regarding Commerce approving nine licenses involving three parties on State's watchlist.

See comment 5.

o Finally, we would like to request that GAO provide us with the complete listing of all 197 names allegedly missing from Commerce's watchlist. We appreciate GAO providing us with a sampling of ten of these names and would like to pass along our analysis of these. Of the ten names provided, seven of these parties are currently screened on our watchlist. Only one of these seven parties was added to our watchlist based on GAO's input to Commerce provided during this study. Of the three parties that were not on our watchlist, one has been added. We would like to discuss the details of the other two parties with GAO to enable us to complete the screening actions necessary. As our findings indicate that at least 6 of the entries in the sample of 10 were actually properly screened on our watchlist, we would appreciate the opportunity to discuss our findings with GAO in more detail to determine the actual number of entries that might be missing from our watchlist.

See comment 6.

Now on p. 5.

On page eight, in the first sentance under the section "Agencies' Screening Systems Do Not Always Capture Applications With Watchlist Names," this sentence should be reworded as it is misleading. If the parties were on Commerce's watchlist as stated, then all information WAS considered before making any final licensing action.

See comment 7.

Now on p. 6.

In the first sentence of the first full paragraph of page nine, the report states that "Commerce has not ensured that each party is given only one identification number and has in some cases assigned multiple identification numbers to the same party." As the report notes, "BXA has a sophisticated computer name-matching program to assign identification numbers to all parties in its database." The report does not address the entire process and the specific attempts made by BXA to limit multiple

See pp. 6 and 14.

identification (ID) numbers. At the beginning of BXA's automated screening system in the mid-1980's, parties were added if there were any small differences in the name or address. It was believed at this time that this method would ensure no screened names would slip through the application review process.

During the fall of 1992 discussions began between the Director of OIRM and the Director of the Office of Enforcement Support (OES) involving eliminating duplicate companies in BXA's database. Many steps were taken to meet this goal. First, OES took over the coding function from OIRM in December, 1992. This coding function involves reviewing the company matches assigned by the computer system to ensure accuracy, and reviewing and adding companies to those fewer entries the computer did not match. OES took over this function because transaction parties are predominately used by Export Enforcement personnel and thus OES is in a better position to make decisions on matches or additions of companies. Guidance was developed for those individuals in OES that handle this function and specific instructions were included pertaining to limiting the creation of multiple companies in the system.

See pp. 6 and 14.

Next, OIRM proposed completing a massive archiving effort of ID numbers to retire the older and larger number of duplicate or multiple ID numbers that were created during the mid-1980s. This archiving effort was completed by OIRM around Feb. 5, 1993. It eliminated duplications and redundancies, which enabled us to reduce the list by over 50%. After this archiving effort was complete, OES initiated a review of companies in two U.S. states and two foreign countries to determine the percentage of duplicates remaining in the system. This review was completed by OES on March 29, 1993. The total number of entries reviewed was 7,799. The number of multiple entries of three or more ID numbers was 167, or 2% of the total. The number of multiple entries of only two ID numbers was 536, or about 7%.

See pp. 6 and 14.

In addition to this reduction in the numbers of multiple entries, further reductions are already in the pipeline. We have drastically reduced the number of duplicates being added on incoming applications since December, 1992. However, this marked change is reflected only gradually because the screening system holds 5 years of data in its active database. Still, by continuing our yearly archiving process we will eliminate the vast bulk of duplicates that remain in the system during the next few years. Finally, we remain vigilent on our current reviews of new applications and company assignments.

See pp. 6 and 14.

Now on p. 6.

On footnote number 5 on the bottom of page 9, this sentence is inaccurate and misleading and should be re-written as follows. "Enforcement staff are responsible for reviewing applications and considering the information included on the screened party and

See comment 1

then making appropriate recommendations to the licensing officer."

Now on p. 8

See comment 8.

In the second sentence of the second paragraph of page 12, the report states that Commerce must provide an applicant with a detailed explanation as to why an application is denied. This is inaccurate as well. Commerce notifies an applicant of its intent to deny an application first and then ultimately of the final denial decision itself. Under Section 10 (f) of the Export Administration Act (EAA), Commerce must provide specific details only to the extent consistent with U.S. national security and foreign policy.

Now on p. 8

See comment 1.

At the end of the first paragraph on page 13, the report includes a statement that Commerce essentially ignores intelligence information if no derogatory information is uncovered during a pre-license check (PLC) request. This is not an accurate assessment of Commerce's consideration of intelligence information. It is true that we will often request a PLC on transactions where intelligence information is present to establish a collateral source of information. However, even if we cannot corroborate this information in a PLC request, there are other sources available to BXA to tap into to support an unfavorable action on the application. Further, even if these sources do not uncover collateral information, OEL is notified of the original intelligence information. At this point, all pertinent information surrounding the export license application, including the technical level of the commodities, the proposed end-use and end-user, the destination country, the risk of diversion, the current licensing policies in place, and the details and source of the intelligence information are considered before a final licensing decision is made.

See comment 9

See p. 14.

The intelligence community plays exactly the role it should in these matters. That is, it supplies the raw intelligence information to the licensing agencies and allows the technical experts within these agencies to evaluate this information against all other factors involved in the license review process.

Now on p. 9.

See comment 10.

In the first paragraph at the top of page 14, the report states that thousands of watchlist names are of interest to both Commerce and State and that these names are not shared. We agree that additional periodic meetings to discuss this specific area would be beneficial to both agencies and we commit to initiating these efforts. However, based on our experience with State's watchlist, we have doubts that the number of parties that are applicable to Commerce's watchlist is in the thousands. Commerce routinely coordinates with State on matters of mutual interest involving license screening and reviews. Both agencies are very familiar with the general composition of the other's watchlist, and information is shared between the two agencies regarding parties of potential interest for each other's watchlist. For

example, BXA forwards copies of its Economic Defense List (EDL) to State yearly for its use and information. The EDL is a subset of Commerce's screen that, among other entries, includes parties that have been involved in unfavorable PLCs or PSVs, parties that have been denied export privileges or parties that have had past violations of the Export Administration Regulations. We are currently working on providing this information in an automated medium to assist State in its use of this data.

See comment 10.

In the second full paragraph of page 15, the report includes a statement that "...Commerce is very reluctant to share information ...". We believe this statement is inaccurate as we have voluntarily provided State with Commerce watchlist information since the early 1980s. Based on the positive relationship that Commerce and State have maintained over the last several years, we believe that this statement should be explained further or deleted from the report.

Now on p. 10.

See comment 11.

Again, at the top of page 17, there is a statement regarding the "poor" cooperation between Commerce and Customs. As stated previously, we believe that the Commerce-Customs problems are behind us because of the September, 1993 Memorandum of Understanding (MOU) and the new spirit of cooperation between the two agencies. For the most part, this report concerns a time period prior to the MOU.

Now on p. 11.

See p. 11

We appreciate GAO sharing the names of the 179 parties they believe had additional ID numbers that were not properly included on Commerce's watchlist. After analysis of the 179 names, we believe that 129 of these names (72.5%) may no longer require Export Enforcement review, and can be removed from Commerce's watchlist without compromising enforcement concerns. A more detailed review and analysis of these 129 names is currently underway. Our review also indicated that 20 of these parties (11%) are, in fact, properly on the watchlist. Finally, 5 of these parties (3%) are no longer being monitored by EE personnel and have been removed from the watchlist.

See comment 12

RESPONSES TO RECOMMENDATIONS

RECOMMENDATION: Formally assign watchlist data-entry responsibilities among the staff and establish procedures to ensure data entries are complete and up to date.

RESPONSE: We fully assigned all watchlist data-entry responsibilities within the Office of Enforcement Support in October, 1993. In response to this report, we have begun to develop programs that will facilitate periodic reviews of all parties entered on Commerce's watchlist to ensure entries are complete and up to date. These reviews will begin by July 1, 1994.

See comment 4.

RECOMMENDATION: Share the relevant portion of Commerce's watchlist with State on a regular basis and incorporate the relevant portion of State's watchlist into Commerce's watchlist.

RESPONSE: We currently share relevant portions of Commerce's watchlist with State by forwarding annually BXA's Economic Defense List. Moreover, we are prepared to make available all portions of our watchlist that State deems relevant to its needs. Additionally, we are prepared to review State's watchlist in further detail to determine what portions may be relevant for BXA.

See comment 10.

RECOMMENDATION: Review Commerce's identification number assigning procedures to ensure that multiple numbers are not assigned to the same party.

RESPONSE: From October to December, 1992, we completed a major purging of multiple entries and reduced the number of these entries by over 50%. Since December, 1992, we have operated a system that has largely arrested the problem of adding multiple entries. Its two-step procedure combines computer automation and human quality control review. Each day, BXA's computer system automatically assigns approximately 75% of the ID numbers to parties involved in export license applications on the basis of both name and address-matching criteria. Individuals within OES then review all matches made by the computer to ensure they were done appropriately, and manually assign ID numbers to the remaining 25% of the parties who cannot be matched automatically.

See pp. 6 and 14.

RECOMMENDATION: When pre-licensing checks are conducted because of information from intelligence sources but they result in no

derogatory information, notify the intelligence sources that the information was not corroborated and discuss whether the application should be approved.

See p. 14.

See comments 4, 8, and 9.

RESPONSE: As discussed earlier, we believe that the intelligence community's role in this process is to provide the rew intelligence information and that the licensing egencies should evaluate thie information in light of all other information known and then make the final decision. Whenever a pre-license check contredicts intelligence information, Commerce will provide its results to the original source agency.

The following are GAO's comments on the Department of Commerce's letter dated June 2, 1994.

GAO Comments

1. We modified the report as appropriate according to Commerce's suggestions.

2. Commerce and intelligence agency officials told us that Commerce has taken the extra step to consult with the intelligence agencies only about three times in the past 5 years. Further, when asked, Commerce officials could not provide any examples where they denied a license based on intelligence information from its watchlist.

3. We revised this section to more clearly emphasize our point that Commerce is not most effectively using available intelligence information in its licensing decisions.

4. Although Commerce stated that it has had formalized procedures since 1989 for controlling what information should be entered on its watchlist and by whom, it acknowledged that its procedure for entering the Department of Justice list was established only in October 1993, after we brought it to Commerce's attention. We further note that the Office of Enforcement Support did not have formalized procedures or written guidance to ensure that all pertinent information was entered into the watchlist. Commerce did not address in its comments why it had not established procedures for entering information from State's Blue Lantern inspection program or why it lacks documentation and guidance on the use of intelligence reports for its watchlist. Moreover, Commerce did not explain why so many names were missing from its watchlist.

5. We are providing the entire list of the missing parties to Commerce as originally agreed.

6. We note these ten names were not found on Commerce's watchlist when we checked, but were likely added to the list after our check. Our point that Commerce's watchlist was not complete and current at the time of our check remains valid.

7. Our analysis showed that Commerce processed over 800 licenses involving parties on its watchlist without considering the derogatory information. None of these licenses were flagged by Commerce's screening system or sent to the enforcement staff for review.

8. When the details for denying license applications are based on or involve intelligence information, it is reasonable to expect Commerce to go back to the intelligence source to assess the merits of the intelligence information and determine whether the information can be sanitized to permit its use for a denial if warranted.

9. Our recommendation seeks to ensure the enforcement staff routinely coordinate with the intelligence community when a pre-licensing check, which has limitations, does not corroborate the intelligence data. Merely passing the original intelligence to the licensing officer will not be helpful because, under the agreements with the intelligence community, the licensing officer cannot use it to deny a license unless the intelligence community is first consulted.

10. Commerce's Economic Defense List is published only once a year. Further, coordination is now done on a limited case-by-case basis; we believe the agencies' compliance and enforcement functions would greatly benefit from a routine sharing of the watchlist information. State's response to our draft report acknowledged the utility of greater sharing of watchlist information.

Our draft report noted that not all of the watchlist entries would be relevant to both agencies. Our estimates of the number of entries relevant to each agency were made on the basis of a review of the categories of names on each list and each agency's enforcement interests. Limitations on our estimates are cited in app. V. Nevertheless, our approach provides a valid indication of the problems we cite. The precise number of entries that are relevant to each agency cannot be determined until the agencies actually share their watchlists.

11. The statement has been deleted.

12. Whether or not the 179 parties should remain on Commerce's watchlist is Commerce's decision, but the removal of those parties from the list does not invalidate our analysis that they were not screened when they were on the watchlist and of enforcement concern.

Appendix VII

Comments From the Department of State

Note: GAO comments supplementing those in the report text appear at the end of this appendix

United States Department of State

Washington, D.C. 20520

JUN 6 1994

Dear Mr. Conahan:

We are pleased, on behalf of the Chief Financial Officer, to provide the Department of State comments on your draft report, "EXPORT CONTROLS: License Screening and Compliance Procedures Need Strengthening," GAO/NSIAD-94-178, GAO Job Code 463833.

If you have any questions concerning this response, please call Mr. Phillip Kosnett, State - PM/DTC, at 875-5664.

Sincerely,

Carolyn S. Lowengart
Director
Management Policy

Enclosure:
As stated.

cc:
GAO - Mr. Ting
State - Mr. Kosnett

Mr. Frank C. Conahan,
Assistant Comptroller General,
National Security and International Affairs,
U.S. General Accounting Office.

GAO DRAFT REPORT -

"EXPORT CONTROLS: License Screening and Compliance Procedures Need Strengthening," GAO/NSIAD-94-178, GAO Job Code 463833

Overview

State's Office of Defense Trade Controls (DTC) is responsible for regulating and facilitating responsible defense trade consistent with U.S. foreign policy and national security goals.

We agree with much of the draft's analysis; we are already implementing most of the draft's recommendations. Yet there are several areas of interpretation and methodology which we believe require reassessment on the part of GAO:

Interagency Cooperation

We agree that State and Commerce could do more to exchange watchlist information, and we are working to do so. Yet we are also unclear on the methodology GAO used to conclude that about 30,000 of the 33,000 entries on the Commerce list relevant to State were not on State's watchlist. We believe there is already greater overlap than the draft report states; GSA's list of firms barred from USG contracts comprises about 19,000 of the entries on both lists. Many of the entries on Commerce's database are for companies with no interests or activities related to defense trade. We request clarification of these figures.

See comment 1.

Moreover, State and Commerce do exchange information to identify and prevent questionable exports by means other than database

Now on p. 9
See comment 2

sharing, and we believe the report could be improved by an explanation of this. The implication (for example, on Page 15, Para 3) of refusal to share information gives an incomplete picture of interagency cooperation on export license compliance.

Watchlist Procedures

See p. 14
See comment 2

We agree that DTC's watchlist needs to be expanded and procedures modified to ensure that full advantage is taken of this resource and accurate records are kept. We have already taken steps in that direction. That said, we believe the draft is based on a fundamental misunderstanding (e.g., Page 7, Para 3; Page 11, Para 2) that any time State issued a license to a company which was on a watchlist, State erred. This misunderstanding of DTC's compliance function needs to be corrected.

The purpose of placing firms or individuals on the watchlist is not to ensure denial, but to ensure appropriate review. Entries are made in the watchlists for varying purposes, reflecting information of varying reliability and problems of varying severity (ranging from ineligibility for U.S. Government contracts to potentially politically sensitive end users).

Now on p. 7.

See comment 3.

Some companies are placed on the watchlist to ensure monitoring of specific types of exports (e.g., those regulated by the Missile Technology Control Regime), without a presumption that the firms would be denied the opportunity to engage in unrelated transactions. For example, in one case cited by the draft (Page 11, para 2), State issued licenses to a company which had been debarred. In this case, the debarment was intentionally structured to allow for exceptional exports to the company seen as in the interest of the USG, and the licenses were issued in keeping with that policy.

Now on p. 5.

See comment 4

In other cases, State will issue a license after a review of derogatory information (obtained via the watchlist or other sources, such as interagency committee consultations) and a determination that the information provided insufficient grounds for denial. For example, the draft cites an Indonesian company (page 8, para 1) as an example of a firm which slipped through the cracks. In fact, Commerce informed State that the company was not a violator.

See comment 5

Our intent is not to quibble over GAO's examples. GAO's criticism that DTC has not computerized record-keeping of compliance review and thus does not always know or cannot demonstrate what compliance actions it has taken is a valid one. Yet we strongly believe the draft needs to be modified to explain to the reader the purpose of the watchlist.

Documentary Proof of U.S. Person Status

We believe there is some confusion in the draft report between the term of art "U.S. person," as defined at Section 120.15 of the International Traffic in Arms Regulations (ITAR), and the specific term "U.S. citizen." The recently revised ITAR definitions of "U.S. person" and "foreign person" have reinstated DTC's practice of including "lawful permanent residents" as "U.S. persons." U.S. citizenship is not a requirement for AECA/ITAR purposes so long as an applicant meets the definition of "U.S. person." It is our understanding that the "U.S. person" requirement exists to facilitate United States jurisdiction over any violator. We have generally required that applicants certify their U.S. person status as a less burdensome alternative to providing documentary proof.

See comment 6

We agree that we generally receive no documentary proof that an applicant is a U.S. person. However, we receive assurances through applicants' certifications and conduct spot verifications of that information. Misrepresenting U.S. person status can subject a person to a fine of up to $1,000,000 or imprisonment up to ten years, or both.

Without knowing specific details about the case described, we are unable to respond on point. Still, given the above circumstances, it is possible that no violation occurred at all.

Specific suggestions for modifications to the text follow.

Legal Questions

See comment 2.

Page 1, Para 1: The draft states that munitions licenses are to be "issued only to U.S. persons as required by law." Section 38(g)(5) of the Arms Export Control Act specifies that "A license to export an item on the United States Munitions List may not be issued to a foreign person (other than a foreign government)." We recommend the draft be modified to read "issued only to U.S. persons or foreign governments as required by law." The same change is necessary in Page 2, Para 2.

See comment 2

Page 2, Para 3: The draft's statement that "Congress amended AECA to authorize State to deny licenses to persons with criminal records" would benefit from clarification. Section 36(g)(3)(4) of the AECA grants this authority to State only in regard to certain circumstances and crimes. Violations of statutes other than those enumerated in the AECA, even for serious crimes, are not grounds for denial of a license. We recommend the draft be modified to read "Congress amended AECA to authorize State to deny licenses to

persons who have been convicted of violating specific statutes enumerated in the AECA."

See p. 3.
See comment 6.

Page 5, Para 1, Line 5: State does conduct limited spot verifications; we recommend replacing "do" with "limited."

Now on p. 8
See comment 2.

Page 12, Para 2: We suggest clarifying the language regarding State's denial authority by changing the first sentence to read: "Under AECA, State has broad authority to deny an application on national security or foreign policy grounds without having to provide a detailed explanation."

Now on p. 12.
See comment 2

Page 19, Page heading: Replace "CITIZENSHIP" with "U.S. PERSON STATUS." (Applicants are not required to prove citizenship.)

Now on p. 13.
See comment 2

Page 19, Para 1-3: New application forms introduced in 1993 integrate the "U.S. person" certification (formerly a separate letter) into the form, eliminating the problem of missing certifications. DTC does, in fact, conduct spot verifications of certifications. We suggest the following changes to the language:

See comment 2.

Para 1, Line 2: Change "citizenship" to "U.S. person status."

Para 1, Line 5: Change sentence beginning "Moreover, they do not conduct..." to "State officials say that they conduct limited spot verifications of the certifications."

Para 1, Line 7: Insert "absolute" before "assurance." (The certification does provide assurance.)

See comment 2.

Para 2, Line 4: Change "is a citizen..." to "either is a citizen or national...." (Section 126.13 of the ITAR provides that a natural person may belong to certain specified categories.)

Para 3, Line 3: Change "U.S. citizen" to "U.S. person."

Now on p. 13

See comment 2

Page 20, Para 1, Line 4: If GAO's point is that the person signing was a non-U.S. citizen, change "person" to citizen. ("Foreign person" is a term of art in the ITAR. The ITAR term "U.S. person" may include non-U.S. citizens who are lawful permanent residents and thus "U.S. persons" for ITAR purposes.)

Interagency Cooperation

Now on p. 9

Page 4, Para 2: In line with the comments made in the Overview, we recommend changing the paragraph to begin:

See comment 2.

"State and Commerce exchange some information regarding export policies, departmental sanctions, and questionable license applications via interagency coordinating committees, such as the Technology Transfer Working Group and the Missile Technology Export Control Committee. Cooperation between State and Commerce on database integration has been limited. The agencies..."

Now on p. 10
See comment 7

Page 15, Para 3: We believe a more accurate picture of the State/Commerce effort to improve information sharing would be:

"State officials stated that they recognize the utility of greater database integration with Commerce, and the agencies have had discussions to this end. Implementation has been hampered by technical difficulties (e.g., computer hardware and database format incompatability) but both agencies wish to pursue the effort. Commerce officials noted..."

Watchlist Procedures

Now on p. 4.

Page 6, Para 2: We recommend adding a sentence at the end of the paragraph:

See comment 2.

"State officials say that, since the time of the GAO review, State has assigned to a specific compliance division employee responsibility for monitoring the watchlist and ensuring receipt of other agencies' information that is produced at regular intervals."

Page 9, Para 3/Page 10, Para 1: State has placed a high priority on upgrading DTC's computer system. Many recent innovations (e.g., electronic license submission, electronic intra-agency staffing) have focused on the licensing side, in a successful effort to meet U.S. industry's needs for efficient processing. A number of small modifications (e.g., creation of an end-use check database) support compliance directly. We are now turning to address some of the issues noted in the GAO draft. In addition, the procedural guidelines provided to all compliance division personnel contains a section explaining the use of the watchlist.

We recommend adding a paragraph on Page 11 before the current Para 2:

individuals on the watchlist is not to ensure automatic denial, but to ensure thorough review. Issuance of a license to a firm identified on the watchlist should not be taken as prima facie evidence of error. Some companies are placed on the watchlist to ensure control of specific types of export, without a presumption that the firms should be denied the opportunity to engage in unrelated transactions. In other cases, State will issue a license after reviewing derogatory information and determining that the information provides insufficient grounds for denial."

See p 14
See comment 2

Page 15, Para 2: Again, we are unclear on the methodology GAO used to conclude that about 30,000 of the 33,000 entries on the Commerce list relevant to State were not on State's watchlist. We request that this paragraph be deleted or rewritten to make the case more explicitly.

Now on p 10

See comment 1

Agreement Procedures

Page 17, Para 2: We acknowledge that, in light of resource constraints at DTC, collecting, filing, and monitoring of agreements and sales reports have not been top priorities. In an effort to achieve the same compliance goals with fewer resources, State is considering a system whereby companies would certify that they were maintaining these records and would be subject to spot audits and to sanctions if they fail to do so." We suggest adding a sentence at the end of Page 18, Para 2 that:

Now on p 12

See p 12

"State officials note that in an effort to achieve the same compliance goals with fewer resources, State is considering a system whereby companies would certify that they were maintaining these records and would be subject to spot audits and to sanctions if they fail to do so."

Blue Lantern

Page 18, footnote: The reference to Blue Lantern is not an accurate paraphrasing of the 1993 Federal Managers' Financial Integrity Act (FMFIA) report and raises issues which cannot accurately be addressed in a footnoted or parenthetical aside. We recommend dropping the footnote or, if GAO believes the reference is warranted, replacing it with the following accurate text from the FMFIA report:

Now on p. 12

See comment 2

"In December 1993, State reported that 'Despite major improvements in the Department's management of defense trade, reported under the material weakness for munitions control, weaknesses still exist in overseas post implementation of the process used for end-use checks used to verify compliance with the

Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR). As a result, the Department does not have reasonable assurance that defense exports are not diverted to unauthorized use.'"

Recommendations

We acknowledge the usefulness of these recommendations, and have already taken steps commensurate with them:

See p. 4

-- Formally assign watchlist responsibilities: Since the time of the GAO review, State has assigned to a specific compliance division employee responsibility for monitoring the watchlist and ensuring receipt of other agencies' information that is produced at regular intervals.

See comments 2 and 7.

-- Share with Commerce: We have reinvigorated efforts to overcome technical obstacles to improving the exchange of watchlist information with Commerce. We continue to exchange other forms of information relating to export concerns via interagency coordinating groups like the Technology Transfer Working Group and the Missile Technology Export Control Committee.

See pp. 6 and 13.

See comment 8

-- Redesign State's screening system: DTC's in-house systems staff is currently reprogramming the Office of Defense Trade Controls' dedicated computer system to flag applications when any party is on the watchlist, and to prevent a flagged license from being logged out for issuance until compliance staff have completed their review. This is technically straightforward, but may have implications for licensing efficiency (because more licenses will be delayed in processing while the compliance division reviews the increased number of flagged applications). We view this as an experiment, to determine what benefits to compliance accrue and what costs in licensing efficiency must be paid.

See comment 9

The system already has the capability to permit record-keeping on compliance actions, and the compliance division has implemented procedures to ensure that compliance staff use the computer in documenting their actions.

State is examining other systems improvements in support of compliance as part of an ongoing enhancement of the Office of Defense Trade Controls computer system (including migration to open systems ADP).

See p. 12.

-- Update agreement files: In an effort to obtain the same compliance goals with fewer resources, State is considering a system whereby companies would certify that they were maintaining there records and would be subject to spot audits and to sanctions if they fail to do so.

See comment 6

-- Document or audit U.S. person status information: Applicants are already subject to spot verifications of the "U.S. person" certification.

The following are GAO's comments on the Department of State's letter dated June 6, 1994.

GAO Comments

1. Our draft report acknowledged that not all of the watchlist entries would be relevant to both agencies. Our estimates of the number of entries relevant to each agency were made on the basis of a review of the categories of names on each list and each agency's enforcement interests. Limitations on our estimates are cited in app. V. Nevertheless, our approach provides a valid indication of the problems we cite. The precise number of entries that are relevant to each agency cannot be determined until the agencies actually share their watchlists. We note that Commerce's list of about 33,000 entries does not include GSA's list of about 19,000 entries.

2. We modified the pertinent section of our report as appropriate based on State's comments.

3. State's compliance officials told us that when a company is debarred by State, it can be issued a license only if an exemption is granted by State and that the exemption is granted only on a case-by-case basis. This particular company was issued 4 licenses without receiving any exemptions from State.

4. In this particular case, the Indonesian company was listed by Commerce as a subject of unfavorable pre- or post-license check. Had that information been considered, the decision may or may not have been different.

5. We stated clearly on page 2 of our draft report that the purpose of the watchlist is to prompt closer agency review of license applications.

6. Our review did not reveal random or spot verifications were routinely done by State; rather, we were told that when State officials see an unfamiliar signature on an application, they may call the company to query whether the person is a U.S. person. State does not document its queries and, in any case, does not require documentary evidence to corroborate or verify the certifications.

7. At no time during our review did either State or Commerce inform us of their attempt to integrate their watchlists or the technical difficulties involved.

8. Licensing efficiency is not more important than a thorough review of applications involving parties on the watchlist. While licensing efficiency is desirable, the AECA requires State to screen all applications for questionable parties.

9. The compliance staff's use of the computer to document their actions would make an incremental improvement over the current system. However, we continue to believe that State should redesign its system to permit automatic flagging of licenses with any watchlist names and to ensure these licenses are not issued until compliance staff have completed their reviews. Fully implementing this recommendation would result in a major improvement in State's compliance and enforcement functions that could also enhance licensing efficiency.

Appendix VIII

Comments From the U.S. Customs Service

THE COMMISSIONER OF CUSTOMS

WASHINGTON, D.C.

June 6, 1994

Frank G. Conahan
Assistant Comptroller General
National Security and International
Affair Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

In response to your request to the Secretary of the Treasury dated May 23, 1994, for comments on the General Accounting Office (GAO) draft report entitled, Export Controls: License Screening and Compliance Procedures Need Strengthening, the U.S. Customs Service has reviewed the draft report.

The report recommends in part, that State and Commerce share their respective watchlists with each other on a regular basis. The recommendation should enhance enforcement of the Export Administration Act (EAA) and the Arms Export Control Act (AECA).

We appreciate the opportunity to review the draft report.

Sincerely,

George J. Weise
Commissioner

TESTIMONY OF
WILLIAM A. REINSCH
UNDER SECRETARY OF COMMERCE FOR EXPORT ADMINISTRATION
BEFORE THE
UNITED STATES SENATE
COMMITTEE ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON FEDERAL SERVICES
JUNE 15, 1994

I am pleased to be here today to discuss the program the Commerce Department has in place to enforce our dual use export control system.

As you know, I have strong ties with this institution - I worked over twenty years for the Congress, including fourteen years as the principal staffer on export control issues for the late Senator John Heinz, and most recently two years for Senator Rockefeller. I was confirmed as Under Secretary for Export Administration on May 2, 1994, and hope I will be able to make a contribution to the Clinton Administration's effort to update and improve our export control system, so we can better achieve our national and economic security goals.

As we continue to streamline and reform our control system, it is clear that further decontrol can be justified only to the extent we have an aggressive and credible enforcement system that is effective at keeping critical technology out of the hands of would-be proliferators. I am committed to ensuring that such an enforcement system is in place.

I would like to take a few minutes to discuss our procedures for screening export license applications, verifying information and assuring that licensed exports go only to approved recipients. I will also comment on GAO's recent review of our license screening system and discuss some of the improvements we have made which address the concerns raised in the report, as well as on-going efforts on the part of this Administration to strengthen and improve our enforcement. I believe that our current system functions effectively, but there is always room for improvement, and I am committed to it.

ENFORCEMENT SCREENING PROCEDURES:

In reviewing export license applications, we rely on many sources of information, including in-house expertise, intelligence reports, open source information, pre-license and post-shipment checks and government to government assurances. Each source has its own strengths and limitations. For example, intelligence information may provide insights not available anywhere else; yet have limited utility because of the need to protect sources and methods. Pre-license check information may give us the advantage of a first hand visit to the proposed consignee, but his or her

candor may be limited by the fact that the checks are overt inquiries by U.S. Government personnel. It is important to bear in mind that merely placing a name on our watch list does not mean that all license applications involving that party should be denied. Some names are placed on the list in the initial stages of an inquiry for the purpose of gathering additional information. It would be improper to deny all license applications involving a particular party merely on the basis of suspicion or rumor.

In evaluating a license application, we use the techniques that are appropriate to the facts of each case. By capitalizing on the strengths of each source of information, we have a system which fosters reliable, timely decisions and thereby protects our strategic interests.

The principle techniques we utilize are:

- Screening license applications
- Pre-license checks
- Post shipment verifications
- Safeguards visits
- Government to Government Assurances
- Inter-agency review of license applications

In addition we provide the Customs Service computer access to all of our completed licensing decisions. This enables Customs to use the information when examining shipments at the port of export to assure that the goods shipped conform to the statement on the license application. Moreover, it provides valuable information for their investigative activities. Finally it provides a mechanism for Customs to give us a warning in time to suspend or revoke a license before shipment to an unreliable party.

Screening license applications

The recent GAO study you requested reviewed our screening procedures in some depth. At the outset let me say that, although we disagree with some of the details in the report, we believe that its recommendations are constructive and will result in improvements to the system. In fact, we have already implemented, or are in the process of implementing, virtually every recommendation GAO made.

Last year, the Department received over 25,000 export license applications. The vast majority of these reflect the legitimate transactions of law-abiding businesses. However, about one-fifth of these applications were subjected to heightened scrutiny because they contained one or more names that were on our watchlist. After reviewing these applications in light of existing in-house information, Export Enforcement was able to

recommend that about 500 licenses not be approved. We believe our screening process provides a cost effective method of review that separates out questionable applications and identifies those which need greater scrutiny without unduly delaying legitimate export transactions.

Pre-license Checks:

Sometimes we need more information than we have in house to properly evaluate a license application that is flagged by our screening system, and we need to employ pre-license checks or safeguards visits. These procedures are among our most important tools to verify the legitimacy of the consignee and the information on the license application because they allow a representative of the U.S. Government to observe first hand the consignee's premises and interview officials of the firm.

On the other hand, they have limitations. They are time and resource consuming -- we depend largely on Foreign Commercial Service officers in our embassies to conduct them in addition to their normal duties -- and because they entail an overt contact with the consignee by a U.S. government employee, they alert all parties to our heightened interest in the transaction.

Last year we conducted 375 pre-license checks. Eighty-five of these checks (approximately 23 percent) uncovered reasons not to approve. We believe that these numbers indicate that we are using this resource appropriately.

We also performed a number of safeguards trips. During these trips, Office of Export Enforcement special agents both reviewed the legitimacy of specific export transactions and provided guidance to both U.S. Foreign Service personnel and host country officials on export controls. This program, because of its high visibility, sends a message to foreign governments of the importance that the United States attaches to effective export controls.

Post-shipment Checks:

Our post shipment check program is a valuable tool for preserving the integrity of the export licensing system. When exporters and consignees know that the United States government conducts verifications to ensure that the terms of the export license have been complied with, they will be less inclined to submit false statements on license applications.

Government to Government Assurances

Government to government assurances elicit the cooperation of foreign governments in preventing diversions. We may seek assurances as to the end use as well as assurances against

diversion to other countries.

Review of Shipper's Export Declarations

Each month we obtain a CD ROM summary of the shipper's export declarations representing all of the exports from the United States for the previous month. We analyze the data to detect shipments made without a required validated license and other violations of our export control laws. So far in FY 94 our analysts have forwarded over 500 such leads to our investigators because of this program. In addition our field offices conduct spot checks of Shipper's Export Declarations in the ports. Our review of Shipper's Export Declarations make it clear to U.S. exporters and would-be diverters that the statements they make on export license applications and other export control documents are subject to government scrutiny.

Referral of License Applications to Other Government Agencies

In addition to the in-house expertise here at Commerce, we also draw on the knowledge and experience of the State Department, the Defense Department, the Department of Energy and the Nonproliferation Center when we evaluate license applications. Currently we refer approximately 54 percent of all license applications to one or more other agencies. We send the most sensitive applications (about thirty percent of the total) to the Nonproliferation Center (NPC) for comment on the legitimacy of the parties to the transactions. The NPC queries the various members of the intelligence community for available information on the purchaser, the intermediate consignee, and the ultimate consignee. We are working with the NPC toward 100 percent referral of all applications received and expect to implement this arrangement in the near future. The availability of up-to-date intelligence information is essential to responsible licensing determinations.

Whatever techniques we use to obtain information for consideration of license applications, we evaluate the results in light of all other knowledge we possess concerning the commodity, its possible end uses and the parties to the transaction. In-house Commerce personnel, pre license checks and experts from other Government agencies are brought into the process whenever appropriate. In addition our program of Shipper's Export Declaration review helps us ensure accuracy in the information applicants submit on their applications.

That, in brief is what we do to verify the information that is included in export license applications. It is a process that requires case by case judgements as to what techniques to use. We try to select the techniques that best match our needs with respect to each application.

GAO Recommendations

The GAO study produced four recommendations for the Department of Commerce's screening program:

> 1) We should "formally assign watchlist data-entry responsibilities among the staff and establish procedures to ensure data entries are complete and up to date."

At the time GAO reviewed our procedures, we had specific staff responsibilities for all categories of watchlist entries except those we received from the Department of Justice. We have since assigned that responsibility. We are refining our ability to ensure data entries are complete and up-to-date.

> 2) We should "share the relevant portion of Commerce's watchlist with State on a regular basis and incorporate the relevant portion of State's watchlist into Commerce's watchlist."

For years we have furnished the State Department with the Economic Defense List. This list, currently containing approximately 7,000 names, is the portion of our watchlist of names which we believe is most relevant to State's mission. The list includes all parties about whom we have specific information linking them to activities of proliferation concern. It also includes those who have been the subjects of unfavorable pre-license or post shipment checks, or who have been sanctioned for export control violations.

However, as a result of the GAO recommendation, we will consult with State to determine if there are any additional categories of names on our watchlist which are of interest to them, and we will provide them with all such names. In addition, we are prepared to review State's watchlist in further detail to determine what portions may be relevant for BXA.

> 3) We should "review Commerce's identification number assigning procedures to ensure that multiple numbers are not assigned to the same party."

I believe that we have addressed that problem. Since December, 1992, we have had a system in place that we believe has greatly reduced the number of multiple entries for the same entity. It uses a two-step procedure involving computer automation and human quality control review. Each day, BXA's computer system automatically matches approximately 75% of the parties (exporters, purchasers, intermediate consignees and ultimate consignees) involved in export license applications received that day based on complex criteria for matching names and addresses with existing entries. After this step, individuals within the

Office of Enforcement Support (OES) review for accuracy all matches made by the computer. These employees then compare each of the remaining 25% of the parties to a computer generated list of names and addresses that the software has identified as somewhat similar but not identical to the party on the application. The employee then decides whether the party on the application is the same as an existing party in the data base, and if so, selects the existing party. If it is different he or she adds a new entry to the data base.

At one time, when our software was less sophisticated, we deliberately added new entities whenever there was even a slight difference in a name or address and relied more on humans to catch multiple entries. As time passes, the licenses representing that practice will be retired and the problem will diminish. I believe that this procedure, embodying both human and computer review, has greatly reduced the problem. But I am committed to doing more.

Export Enforcement is working with the Bureau's Office of Information Resources Management to bring about further improvements. First, we will develop and utilize a special quality assurance report that will allow our managers to quickly identify difficulties that may occur in the process of adding new entities to the system. Second we will improve the computer interface used by employees who add names to the watchlist to alert them to the possibility of more than one record in the data base for a particular entity. I believe that this will make our watchlist even more effective than it is now.

> 4) We should, "when pre-licensing checks are conducted because of information from intelligence sources but result in no derogatory information, notify the intelligence sources that the information was not corroborated and discuss whether the application should be approved."

We agree only partially with this recommendation. The intelligence community's important role in export enforcement is one of supplying information. It is the role of the licensing agencies to evaluate this information against other available information and then make the licensing decision.

Having said that, however, we agree with the portion of the recommendation which states that we should notify the intelligence community when a pre-license or post shipment check fails to corroborate the intelligence information that prompted it. We are working with Commerce's Office of Intelligence Liaison to develop a mechanism to provide this feedback to the intelligence community.

STRENGTHENING OUR ENFORCEMENT CAPABILITIES: THE ADMINISTRATION'S EXPORT ADMINISTRATION ACT (EAA) PROPOSAL.

Of course, no export control program, however thorough, can do the job without effective enforcement. To this end, the administration has proposed strengthening our enforcement capabilities in the Export Administration act renewal that is currently pending before the Congress. It will increase penalties for violators and, at the same time, simplify and streamline our export control structure.

Conclusion

I am committed, as part of the Clinton Administration, to strengthening our export control program. We will minimize the burden on law-abiding exporters by avoiding unnecessary controls. We will continue to carefully scrutinize export license applications. We will employ all available resources and methods as appropriate to a particular case. We will strengthen the system of screening license applications along the lines suggested by the GAO.

TESTIMONY OF
THOMAS E. McNAMARA
PRINCIPAL DEPUTY ASSISTANT SECRETARY
FOR POLITICAL-MILITARY AFFAIRS
DEPARTMENT OF STATE

BEFORE

SUBCOMMITTEE ON FEDERAL SERVICES,
POST OFFICE, AND CIVIL SERVICE
SENATE GOVERNMENTAL AFFAIRS COMMITTEE
JUNE 15, 1994

Thank you very much, Mr. Chairman, for the opportunity to appear before your subcommittee to discuss the important topic of export licensing. As you and the Congress appreciate, the licensing of arms for commercial export is a complicated and often sensitive process involving billions of dollars of U.S. exports. Defense export licensing has important implications for the national security, economic security, and foreign policy interests of the United States as well as the well-being of thousands of American companies and their employees.

I know that this is an area in which you have long provided leadership. The Department of State is committed to giving the regulation and facilitation of responsible defense trade the attention and the resources it deserves, and to improving the efficiency, speed, and security with which it carries out these functions.

Before I address specific compliance issues, let me briefly outline some of the steps the Department of State has taken to improve the export licensing process, including the compliance function.

Since 1990, we have reorganized the former Office of Munitions Control into an Office of Defense Trade Controls -- known as DTC -- increasing staff from under thirty to approximately 60. This expansion included augmentation of the office with officers from the military services, the Customs Service, and -- shortly -- the National Security Agency. These augmentees bring a wealth of specialized expertise to DTC, and enhance coordination with their agencies resulting in a significant increase in the efficiency of the licensing and compliance functions.

We have also strengthened the development of defense export policy through the creation of a policy office, originally known as the Office of Defense Trade Policy, and assured strong liaison by teaming the two offices in a "Center for Defense Trade."

In recent months we have augmented the Office of Defense Trade Policy with personnel who worked previously in other bureaus on the development of high-technology export policy. In accordance with this broadened mission, we have renamed it the Office of Export Control Policy, or EXP, and discontinued the use of the nomenclature "Center for Defense Trade." We have maintained tight cohesion between DTC and EXP and have upgraded the position of the supervisor of the two offices to Deputy Assistant Secretary.

We have also obtained permission to fill the position of Director of the Office of Defense Trade Controls at the Senior Executive Service level, to assure continued first-rate management of this critical function.

Within DTC, we have invested aggressively in automation of licensing and compliance operations. We have instituted an electronic Remote On-Line Bulletin Board to improve communication with license applicants, and an electronic staffing network to improve coordination with the State Department bureaus and other agencies which provide DTC with policy and technical guidance.

In recent months, we have scored a great success with the long-awaited introduction of electronic license submission. Over 300 companies participating in the project have this year submitted over 1600 licenses via computer, with payoffs for the firms and for the Government in speed, efficiency, and savings. While paper applications remain the norm, we are strongly encouraging the shift to electronic submission, and are hopeful that electronic licensing will become much more prevalent as we bring more companies into the program.

Since 1990, we have greatly increased the funding provided to DTC for the performance of its mission. We are grateful for your assistance, Mr. Chairman, in supporting enhanced funding for the Office of Defense Trade Controls via the "plowback" formula.

Since 1990, we have published a quarterly magazine, Defense Trade News, to provide information on U.S. export policy and on operational licensing and compliance matters to thousands of readers in industry, Congress, government agencies, and other American and foreign audiences.

We have reached out to industry via an extensive program of in-house seminars and participation in dozens of association conferences and other fora, educating companies on both policy and operational matters to improve government-industry cooperation and encourage compliance with legal requirements.

We have enhanced and formalized the end-use check program, including increased scrutiny of high-risk indicators, greater U.S. embassy participation, and foreign government cooperation.

We have instituted and enhanced compliance procedures, particularly those that implement legislation introduced in 1987. As a result, we have improved registration compliance, dramatically increased assistance to U.S. agencies on investigations and criminal prosecutions, established a unit dedicated to addressing diversions and Congressional reporting requirements, and greatly boosted the number of administrative actions such as debarments, suspensions, revocations, and company audits.

While we have accomplished much in the past four years, we are not resting on our laurels. We continue to move apace on electronic licensing and other aspects of DTC automation, including steps to computerize procedures to enhance coordination between the licensing and compliance functions. In accordance with the National Performance Review process, we are carefully studying DTC's internal staffing and organization to determine how to improve efficiency and save on personnel costs without sacrificing performance.

The General Accounting Office recently noted a number of steps which can be taken to improve the handling of the compliance function. We concur with much of GAO's analysis, and have been taking steps to implement most of the specific measures they recommended.

1) The GAO review suggests that we tighten procedures for ensuring that the compliance "watchlist" is properly updated and monitored. We have done so, formally assigning employee responsibility for monitoring the watchlist and receipt of information from other agencies which is produced at regular intervals.

2) We have reinvigorated efforts to overcome technical obstacles to improving the exchange of watchlist information with Commerce. We continue to exchange other forms of information relating to export concerns via interagency coordinating groups like the Technology Transfer Working Group and the Missile Technology Export Control committee.

3) Currently, the Office of Defense Trade Controls' dedicated computer system "flags" applications for compliance review when the applicant appears on the watchlist. DTC's in-house systems staff is currently reprogramming the system to "flag" applications when any party is on the watchlist, and to prevent a flagged license from being logged out for issuance until compliance staff have completed their review. This is technically straightforward, but may have implications for licensing efficiency (because more licenses will be delayed in processing while the compliance division reviews the increased number of flagged applications). We will determine, following a trial period, the best way to accomplish this.

I would note in this regard that the purpose of placing firms or individuals on the watchlist is not to ensure denial, but to ensure appropriate review. Entries are made in the watchlists for varying purposes, reflecting information of varying reliability and problems of varying severity. Thus there are many cases where DTC intentionally and appropriately issues a license after reviewing watchlist information.

4) The compliance division has implemented procedures to ensure that DTc staff use the computer in documenting their actions. State is examining other systems improvements in support of compliance as part of an ongoing enhancement of the Office of Defense Trade Controls computer system (including migration to open systems data processing).

5) In an effort to attain the same compliance goals with fewer resources, State is developing a system whereby companies would certify that they were maintaining records of manufacturing and distribution agreements, and would be subject to spot audits as well as sanctions should they fail to do so.

6) GAO recommended that DTC document or audit applicants to assure that they are U.S. persons, as required by law. In fact, applicants are screened at the registration stage, and are also subject to spot verifications of the "U.S. person" certification. Moreover, DTC works with most firms over a period of years, developing institutional knowledge of companies' personnel and practices, which facilitates compliance review.

There are elements of the GAO report with which we differ, particularly the GAO view of cooperation between State and Commerce, which we find unduly pessimistic. We are also unclear on the methodology GAO used to conclude that about 30,000 of the 33,000 entries on the Commerce list relevant to State were not on State's watchlist; we believe there is already greater overlap than the draft report states.

Moreover, State and Commerce do exchange some information regarding export policies, departmental sanctions, and questionable license applications via regular meetings of interagency coordinating committees, such as the Technology Transfer Working Group and the Missile Technology Export Control committee.

We found the recent GAO study, like other reviews of DTC procedures over the years, to be a useful and constructive effort to support the defense trade control mission. The effort to improve the defense trade control function is not State's alone; it is truly a team effort, and an interagency one. Through training seminars, conferences, and company audits, we have strengthened U.S. industry's role in the compliance process. Customs, Commerce, and Defense provide critical support and coordination to the Office of Defense Trade Controls, as do numerous elements within the State Department.

Mr. Chairman, we have been particularly gratified by the interest, cooperation and support which the Congress has provided, as exemplified by today's hearing, and look forward to continued cooperation with this subcommittee.

Let me conclude these remarks by saying that, while the "support troops" have been critical to DTC's enhancement, it is the "line troops" at DTC -- the licensing officers, compliance officers, and administrative support staff -- who are the keys to improving the defense trade controls process. They have honed the office's functioning through numerous little-noted innovations. Their daily efforts to serve the interests of the United States, performing their duties with savvy and dispatch, have been primarily responsible for DTC's improving performance and reputation. We are pledged to continue to give them the support they need to get the job done.

Thank you.

SENATOR THAD COCHRAN

OPENING STATEMENT

Governmental Affairs Subcommittee on Federal Services, Post Office, and Civil Service Hearing

A Review of Arms Export Licensing

June 15, 1994

The subject of proliferation is on the minds of many today. One has only to look at the front page of a newspaper or listen to the nightly news to hear about North Korea's efforts to divert nuclear weapons material from its reactor at Yongbyon. As worrisome as the thought is that North Korea might already have a few nuclear weapons or be diverting material to make more to use or threaten to use on South Korea, many are equally worried over the export record of North Korea. Every weapons system ever developed by the North Koreans has been exported, without fail. For example, North Korea has sent Scud-C ballistic missiles to both Syria and Iran, and is currently working on longer-range missiles.

Besides the North Koreans, the other nations on the State Department's list of state sponsors of terrorism -- Syria, Iran, Iraq, and Libya -- are clearly also in the nuclear marketplace.

The dissolution of the former Soviet Union has also created its share of proliferation problems, such as the export to terrorist states of scientists to possible "black market" sales of weapons materials or components to these terrorist states, as well.

The proliferation problem is further compounded by the demise of COCOM, the Coordinating Committee for Multilateral Export Control. This multilateral export regime, which did so much for so many years, went out of existence on March 31 of this year. The Administration says it is working on a something to replace COCOM, but here we are more than two months after COCOM has ended with nothing in its place. This makes very little sense to me.

So, the North Koreans and their circle of terrorist nations, the porous nature of the former Soviet states, and the lack of any multilateral export control regime among Western nations are all reasons for great concern when we think about the flow of information, weapons material, and weapons to nations who will only do harm with weapons of mass destruction.

There is, unfortunately, another problem that must be added to the list. And the problem is one that is right here on our doorstep, and within our ability to solve. Despite the urgency of the international problems caused by proliferation, our executive branch has been unable to develop a reliable system to deny export licenses to companies and individuals who shouldn't receive them for national security reasons. It is really a staggering thought: one part of our government could know of a company that, for national security reasons, should not be permitted to purchase a military or dual-use item, yet an export license is granted by our own government to sell the item. This example is not hypothetical; the report released by GAO today, "License Screening and Compliance Procedures Need Strengthening," gives several examples.

We need to deal with the international proliferation problems we face; we must also give our own internal coordination problems the same degree of urgency and scrutiny. The international and internal aspects of this are but differing facets of the same problem. Both must be paid attention to.

Governmental Affairs Subcommittee on Federal Services, Post Office, and Civil Service Hearing

A Review of Arms Export Licensing

June 15, 1994

HEARING QUESTIONS

Panel One: Mr. Jim Wiggins, GAO Associate Director

1. Your report detailed the shortcomings of the various watchlists among the Commerce and State Departments, respectively.

   •Are these the only departments that have watch lists? If not, what other departments and agencies maintain such lists?

   •How many different export control watchlists are there within the executive branch?

   •Would you recommend that rather than keep individual lists, there be one list administered by a single department that all government agencies add to as frequently as necessary?

2. In your view, is legislation needed to correct the export licensing disarray? If so, what would you recommend be included in the legislation? If not, what regulatory changes would you suggest for this process?

GAO RESPONSE TO SENATOR COCHRAN'S QUESTIONS

1. Other departments or agencies maintain watchlists that are specific to their missions. For example, GSA maintain a watchlist of companies debarred from federal contracts, and Treasury maintains a watchlist of specially designated nationals that are prohibited from any transactions without Treasury approval. Some of these watchlists are of interest only to State or Commerce, while others are of interest to both. Commerce's and State's watchlists incorporate those watchlists from the other agencies that are relevant to their respective mission. Therefore, Commerce and State are the only departments that maintain comprehensive watchlists for export control purposes.

   A single list would work if the entire export control system is run by a single agency under one enabling legislation. Currently, the system is divided between State and Commerce under two very different statutes. Therefore, the criteria used by each agency for placing a party on its watchlist and for denying an application are also very different. Under these circumstances, Congress may wish to consider requiring State and Commerce to share their watchlists on a real-time on-line basis so that each agency can readily access the relevant portion of the other agency's watchlist to help screen its applications.

2. The recommendations we made in our report to improve the license screening system should not require any legislative or regulatory changes. However, it may be advisable to statutorily require the IGs of State and Commerce to test the system periodically and report the results to Congress.

Panel One

Honorable William Reinsch
Under Secretary of Commerce for Export Administration

Honorable Thomas T. McNamara
Acting Assistant Secretary
Bureau of Political-Military Affairs
Department of State

*****The questions are for both witnesses*****

1. Please explain how the various watchlists are formulated. How often are they updated? On what grounds? Are the lists disseminated to departments and agencies that are part of the process each time they're updated?

2. There are clearly problems with export control coordination within the executive branch.

- How would each of you propose to remedy these problems?

- Do you believe there should be one central watchlist within the executive branch?

- Is legislation necessary to address this problem?

3. What role does the CIA's nonproliferation center have in the export license approval process? Does the CIA have its own separate and distinct watchlist?

4. What role does the Defense Department have in the review of export license applications on dual-use items that aren't part of our Foreign Military Sales Program and don't go through the Pentagon's Defense Security Assistance Administration?

Question for the Record Submitted to
Deputy Assistant Secretary of State Thomas E. McNamara
by Senator Thad Cochran
Committee on Governmental Affairs
June 15, 1994

Question:

1. Please explain how the various watchlists are formulated. How often are they updated? On what grounds? Are the lists disseminated to departments and agencies that are part of the process each time they're updated?

Answer:

The State Department regularly receives compliance information from the GSA, ACDA, the Defense Department, the Commerce Department, the Justice Department, the U.S. Customs Service, the Treasury Department, and the Intelligence Community, in addition to information generated by its own compliance enforcement activities (including Blue Lantern end-use checks).

Several agencies provide lists of ineligible parties and of parties convicted of violating export control laws and regulations. Other sources, including the Intelligence Community, open press reports, and the Office of Defense Trade Control (DTC)'s own efforts, produce pieces of information often relating to individual incidents or inquiries. Where the information is appropriate and its inclusion practical, these lists and other pieces of information are incorporated into the DTC Watch List.

The Watch List is updated as information is received or uncovered. The lists from some sources are provided at regular intervals; others are much more sporadic. To ensure that the DTC Watch List is properly updated and monitored, we have formally assigned a Compliance Division employee responsibility for monitoring the Watch List and receipt of information from other agencies which is produced at regular intervals. Because the nature, reliability, and specificity of information we receive varies considerably, often the information must first be reviewed by DTC's Compliance Division to determine if it warrants inclusion in the Watch List. If manual entry of data from other sources is required, timely and complete entry is limited by human resource problems.

Our Watch List, in its entirety, is not disseminated to other parties. This would not be practical or useful. As I indicated, in most cases, State is the collector of other-agency adverse and derogatory information for use in the export control regime under its jurisdiction. We share information with Commerce, which also has a broad--and sometimes related--export compliance function, and we are examining ways to ensure that information of mutual interest is exchanged more fully.

Question for the Record Submitted to
Deputy Assistant Secretary of State Thomas E. McNamara
by Senator Thad Cochran
Committee on Governmental Affairs
June 15, 1994

Question:

2. There are clearly problems with export control coordination within the executive branch.

- o How would each of you propose to remedy these problems?
- o Do you believe there should be one central watchlist within the executive branch?
- o Is legislation necessary to address this problem?

Answer:

The GAO has provided some very valuable clues about how we might approach sharing information among export licensing and control agencies, particularly State and Commerce. We already cooperate, but coordination needs to be strengthened.

Our two agencies have already begun to hold technical expert-level discussions to determine, in detail, what information each holds is mutually relevant and how it can be exchanged in a effective and efficient manner. One area that may be improved readily is the sharing of derogatory information developed or verified during the conduct of end-use checks. Scheduled exchanges of certain categories of information and computer dial-up capabilities to check information data bases may be other fruitful avenues of endeavor.

A central executive branch watch list is likely to be unwieldly because of its length, impractical to coordinate on a timely basis, and most of all irrelevant because agencies often need very different types of information to fulfill legitimately different and separate mandates. Two agencies, State and Commerce, have principal jurisdiction concerning exports. I believe both draw ably upon relevant information that is available from a number of sources. Where there are policy and operational areas of common interest and concern to State and Commerce, sharing information makes sense. We are fully committed to enhancing exchanges of information in these areas.

Because both agencies are actively working to improve coordination, I do not believe that new legislation is necessary.

Question for the Record Submitted to
Deputy Assistant Secretary of State Thomas E. McNamara
by Senator Thad Cochran
Committee on Governmental Affairs
June 15, 1994

Question:

3. What role does the CIA's nonproliferation center have in the export license approval process? Does the CIA have its own separate and distinct watch list?

Answer:

The Nonproliferation Center (NPC) does not and should not have a formal role in the State licensing process. It does, however, serve as a clearinghouse for intelligence information related to munitions exports and trafficking. Such information is regularly passed to the Office of Defense Trade Controls through State's Bureau of Intelligence and Research (INR), and is carefully reviewed in bi-weekly meetings of the Technology Transfer Working Group (TTWG), which is chaired by State.

The CIA maintains certain information about arms exports and transfers. The relevant portions of this data are made available to us through the mechanisms already described (INR, TTWG) as well as through other intelligence reports and briefings. Questions for more specific information should be addressed to the NPC.

Question for the Record Submitted to
Deputy Assistant Secretary of State Thomas E. McNamara
by Senator Thad Cochran
Committee on Government Affairs
June 15, 1994

Question:

4. What role does the Defense Department have in the review of export license applications on dual-use items that aren't part of our Foreign Military Sales Program and don't go through the Pentagon's Defense Security Assistance Administration?

Answer:

I defer to my Commerce Department colleague regarding the licensing of dual-use items since these commodities fall under Commerce's export control jurisdiction.

About 27 percent of the 50,000 munitions license applications received annually by State are referred to the Defense Department for technical evaluation and review of related national security concerns.

United States Department of State

Washington, D.C. 20520

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Dear Mr. Chairman:

We are replying to your letter of June 17 to Acting Assistant Secretary for Political-Military Affairs Thomas McNamara in which you pose follow-up questions concerning the Defense Trade Advisory Group (DTAG) and other license-specific issues. On June 15, Mr. McNamara testified before you on the U.S. arms export licensing system.

The DTAG is the only formal channel allowing private sector individuals to advise the Department on defense trade issues. Since its initial establishment in February 1992, it has made recommendations on the U.S. conventional arms transfer policy review, U.S. arms transfer policy towards Taiwan, automation of the munitions licensing process, and continued revision of U.S. export regulations. Its ambitious 1994 Work Plan includes advising on the development of a comprehensive foreign availability database and examining U.S. arms transfer policy towards Latin America and South Africa, upgrades of Soviet bloc equipment, and the Export Administration Act. Department Principals value the group's suggestions, and we are pleased that you have taken an interest in this important advisory committee.

We hope our responses to your questions will be helpful to you and your colleagues on the Committee on Governmental Affairs. Please do not hesitate to contact us again if we can be of further assistance.

Sincerely,

Wendy R. Sherman

Wendy R. Sherman
Assistant Secretary
Legislative Affairs

The Honorable
David Pryor,
Chairman, Subcommittee on Federal Services,
Post Office, and Civil Service,
United State Senate.

Question for the Record Submitted to
Acting Assistant Secretary of State Thomas E. McNamara
by Senator David Pryor
Committee on Governmental Affairs
June 15, 1994

Question:

I request a list of the members of the Defense Trade Advisory Group (DTAG), including the companies or institutions they represent. I also request a list of the Working Groups of the DTAG.

Answer:

The DTAG is divided into Policy, Regulatory, and Technical Working Groups. The Policy Working Group (PWG) advises the Department on defense trade and technology transfer policies. The Regulatory Working Group (RWG) considers regulatory and licensing procedures applicable to defense articles, services, and technical data. The Technical Working Group (TWG) deals with technical issues involving the U.S. Munitions List (USML). The DTAG Chair and Vice-Chair head the PWG, while the RWG and TWG have their own Chairs.

The Assistant Secretary of State for Political-Military Affairs (PM) appoints the DTAG officers and members. The DTAG Executive Secretary and Designated Federal Official is William Pope, Director of PM's Office of Export Control Policy (PM/EXP). Membership on the committee is for a two-year term. Listed are the 1994-96 members and their affiliations.

DTAG Policy Working Group

DTAG/PWG Chair: William Schneider, Jr.
International Planning Services

DTAG/PWG Vice-Chair: Ramona Hazera
Northrop-Grumman

PWG Members:
Burton Bacheller II, McDonnell Douglas
James Blackwell, SAIC
Edward Bursk, Raytheon Overseas Limited
Samuel Baker, American Defense Preparedness Association (ADPA)
Tyrus Cobb, Business Executives for National Security
Vincent DeCain, NOMOS Corporation
Jacob Goodwin, Bulova Technologies

PWG Members (cont.):
Ruth Greenstein, Institute for Defense Analysis
Joel Johnson, Aerospace Industries Association
Norman Jorstad, Institute for Defense Analysis
Robert Martin, Motorola
Boyd McKelvain, General Electric
Michael McMillan, E-Systems
Jack Merritt, Association of the U.S. Army
Willard Mitchell, Teledyne Industries
James Nelson, Martin Marietta
Janne Nolan, Brookings Institution
Edward O'Connor, GMA, Inc.
Alan Platt, Gibbon, Dunn & Crutcher
Bob Ramsey, Lockheed
Henry Sechler, General Dynamics
Ronald Singer, GE Aircraft Engines
Willis Smith, Boeing
Anna Stout, ALESA
Maxwell Thurman, Association of the U.S. Army
Donald Weadon, Dickstein, Shapiro & Morin

DTAG Regulatory Working Group

RWG Chair:
Jerome Eiler
Northrop-Grumman

RWG Members:
Giovanna Cinelli, Gardner, Carton & Douglas
Richard Colton, Science Applications International
Debi Davis, Martin Marietta
Patrick Donovan, Honeywell
Richard Gogolkiewicz, General Dynamics
Robert Lee, Varian Associates
Judith Morehouse, Boeing
Joyce Poetzl, McDonnell Douglas
Stuart Quigg, Q International
Victoria Ralston, Lockheed
George Rao, Allied Signal Aerospace
Thomas Reed, Rockwell International
Richard Sandifer, Ingalls Shipbuilding
Kevin Shannon, Electronic Industries Association
Stephen Story, Federal Express

DTAG Technical Working Group

TWG Chair:
Mike Richey
Litton Industries

TWG Members:
Philip Gast, Burdeshaw Associates, Ltd.
Harry Halamandaris, Teledyne Industries
John Kopecky, Pratt & Whitney
James Matchett, General Electric Aircraft Engines
Douglas McCormac, TRW Components International
Robert Oliver, Delco Electronics
Joseph Yang, Westinghouse Electric

Question for the Record Submitted to
Acting Assistant Secretary of State Thomas E. McNamara
by Senator David Pryor
Committee on Governmental Affairs
June 15, 1994

Question:

Please supply a list of any meetings that State has held with other groups to discuss arms export matters. For example, has a senior State Department official ever met with representatives from the Arms Trade Working Group, a coalition of public interest groups? Does State think that such a meeting would be advisable? Why or why not?

Answer:

State, and in particular the staff of PM and the Under Secretary for International Security Affairs, meet frequently with private sector persons and groups on a wide range of defense trade issues. For example, the Director of the PM Bureau's Office of Export Control Policy (PM/EXP) met with eight members of the Arms Trade Working Group in February 1994. Discussion focussed on the Clinton Administration's evolving conventional arms transfer policy. In addition, Office of Defense Trade Controls (PM/DTC) staff meet frequently with industry associations such as the Society for International Affairs (SIA), Aerospace Industry Association (AIA), and Electronic Industry Association (EIA).

The Department encourages a government-industry dialogue on defense trade issues, as such interaction allows each to consider the other's point of view. Accordingly, State officials will continue to meet with industry representatives at their request, either in formal sessions such as structured conferences, or in smaller meetings on specific topics. These sessions allow State to explain the rationale behind U.S. arms transfer policies. We note that arms transfers are important foreign policy instruments: we authorize only those transfers which advance U.S. national security, foreign policy, and nonproliferation objectives, and would not approve a proposed arms sale on the basis of commercial considerations.

Question for the Record Submitted to
Acting Assistant Secretary of State Thomas E. McNamara
by Senator David Pryor
Committee on Governmental Affairs
June 15, 1994

Question:

For fiscal years 1992 and 1993, please provide a list of the DTAG members and the number of arms export licenses they received from State.

Answer:

The DTAG members for the 1992-94 term are the members who served during FY'92 - FY'93. The Office of Defense Trade Controls (PM/DTC) maintains a database which records the number of licenses which the defense manufacturing companies the members represent received during that period. This information is listed below.

We wish to point out that there is no connection between the number of export licenses the Department approves for a company and its membership in DTAG.

COMPANY	Number of Licenses for FY'92	Number of Licenses for FY'93
Boeing	141	200
Bulova	24	49
Corning	2	5
E-Systems	167	148
General Dynamics	351	167
General Electric	591	456
General Motors	89	78
Grumman	63	72
Hughes Aircraft	345	703
Litton	1,101	1,068
Lockheed	177	693
LTV Aerospace	69	3
Martin Marietta	121	336
McDonnell Douglas	356	339
Motorola	958	987
Northrop	107	138
Pratt & Whitney	33	9
Raytheon	365	358
Rockwell	750	856
SAIC	43	37
Smith and Wesson	609	597
Smiths Industries	139	94
Teledyne	325	411
Varian	134	171
Westinghouse	204	149

Question for the Record Submitted to
Deputy Assistant Secretary of State Thomas E. McNamara
by Senator David Pryor
Committee on Governmental Affairs
June 15, 1994

Question:

1. You testified that the company that has been convicted of selling to Iran, and then received three licenses from State, was party to a plea-bargaining agreement. When GAO met with DTC employees they were unaware of this agreement. Please provide all relevant documents that demonstrate that DTC was granting these licenses with full knowledge of the prior conviction.

Answer:

On September 10, 1991, when the Department developed enough adverse information to have reasonable cause to believe that the company in question had conspired to violate and had violated section 38 of the Arms Export Control Act, further export privileges were denied and a number of licenses to which it was a party were suspended. As part of the ensuing plea bargain arrangement, the host government of the company and the USG held detailed exchanges about our individual and mutual foreign policy and national security interests. In this context, there was a thorough review of the limited number of weapons systems and subsystems needed on a priority basis to support those critical interests. As part of the plea bargain arrangement, the USG agreed: a) to consider, on a case-by-case transactional basis, licenses and approvals related to these military needs and involving the company in question in support of the foreign government, and b) to rescind suspension of

other licenses and approvals related to these weapons. For the record, I am submitting various public documents, including the consent agreement, that describe our legal and operational handling of this matter.

UNITED STATES DEPARTMENT OF STATE
BUREAU OF POLITICO-MILITARY AFFAIRS
WASHINGTON, D.C. 20520

In The Matter of:	)
JAPAN AVIATION ELECTRONICS INDUSTRY LTD. Tokyo, Japan	)
Respondent	)

ORDER

The Office of Defense Trade Controls, Bureau of Politico-Military Affairs, United States Department of State (Department), having determined to initiate an administrative proceeding against Japan Aviation Electronics Industry Ltd. (JAE) pursuant to Section 38(e) of the Arms Export Control Act (the Act) (22 U.S.C. § 2778(e)) and Section 127.6 of the International Traffic In Arms Regulations (22 C.F.R. Parts 120-130) (the Regulations) based on allegations that JAE violated Section 38(c) of the Act (22 U.S.C. § 2778(c)) and the Regulations, in that JAE transferred or caused to be transferred to Iran, in 1984-87, defense articles covered by the U.S. Munitions List (22 C.F.R. § 121.1), without the prior written approval of the Department of State, as set forth in the proposed Charging Letter;

The Department and JAE having entered into a Consent Agreement whereby the parties have agreed to settle this matter by the payment by JAE to the Department of a civil penalty in the amount of $5,000,000.00 (five million dollars), and;

The terms of the Consent Agreement having been approved by me;

IT IS THEREFORE ORDERED:

FIRST, a civil penalty in the amount of $5,000,000.00 (five million dollars) is assessed against JAE. JAE shall pay the civil penalty to the Department by cashier's check or certified check made payable to the Department of State within ten days of the time of JAE's conviction in the U.S. District Court for the District of Columbia, in a related criminal case (Criminal Number 91-516);

SECOND, the Department's Notice of September 10, 1991, which suspended all existing licenses and other approvals, granted pursuant to Section 38 of the Act, that authorize the export or transfer by, for or to, JAE and any other subsidiary or associated company, of defense articles or defense services, is rescinded;

THIRD, statutory debarment for a period of three years from the date of conviction, with the last two years suspended, is imposed against JAE. If at any time during the period of suspension there is reason to believe that JAE has violated any provisions of the Act and Regulations, or any of the statutes enumerated in Section 38(g)(1), the Department may promptly reimpose statutory debarment;

FOURTH, that the proposed Charging Letter, the Consent Agreement and this Order shall be made available to the public.

This Order becomes effective on the date of conviction in the United States District Court, District of Columbia, of the plea to which JAE and the Department of Justice have agreed in the related criminal case.

Richard A. Clarke
Assistant Secretary
for Politico-Military Affairs

Entered this 6th day of March 1992

Question for the Record Submitted to
Deputy Assistant Secretary of State Thomas E. McNamara
by Senator David Pryor
Committee on Governmental Affairs
June 15, 1994

Question:

2. Were you aware of these large gaps in your watchlist?

Answer:

We are examining the information provided by the GAO very carefully to determine the magnitude of any problems with the organization and content of our Watch List.

DTC regularly receives compliance information from the GSA, ACDA, the Defense Department, the Commerce Department, the Justice Department, the U.S. Customs Service, the Treasury Department, and the Intelligence Community, in addition to information generated by its own compliance enforcement activities (including Blue Lantern end-use checks).

Some agencies, especially GSA, Commerce, Justice, Treasury, and the Customs Service provide various lists of ineligible parties and of parties convicted of violating export control laws and regulations. Other sources of information, including the Intelligence Community, open press reports, and DTC's own efforts produce information in smaller "packets" often relating to individual incidents or inquiries.

Where the information is appropriate and its inclusion practical, these lists and other pieces of information are incorporated into the DTC Watch List. The lists from some sources (GSA and Justice, for example) can be entered electronically. Manual entry of data from other sources is limited by human resource problems. Often the information must first be reviewed by the Compliance Division to determine if it warrants inclusion in the Watch List, and then it must be manually entered. For example, the principal lists received from the Department of Commerce (which includes information received from DTC by that agency), has over 7,000 names which must be reviewed and manually entered, with appropriate adjustments in format to make the information usable within the DTC system.

Question for the Record Submitted to
Deputy Assistant Secretary of State Thomas E. McNamara
by Senator David Pryor
Committee on Governmental Affairs
June 15, 1994

Question:

3. What specific actions have you undertaken to correct these gaps?

Answer:

During the Summer of 1993, DTC staff put in hundreds of hours reviewing each entry in the DTC Watch List, standardizing the format for thousands of entries, categorizing the various entries by their source and/or by the nature of the concerns regarding a particular party named in the list, and organizing the various supporting records. The DTC Watch List now numbers over 33,000 entries and will continue to grow as DTC continues to improve its procedures for vetting and updating the information included in the Watch List.

To ensure that the DTC Watch List is properly updated and monitored, we have formally assigned a Compliance Division employee responsibility for monitoring the watchlist and receipt of information from other agencies which is produced at regular intervals.

We have reinvigorated efforts--via export meetings--to overcome any legal, practical, and especially technical

obstacles to improving the exchange of Watch List information with Commerce.

We continue to exchange other forms of information relating to export concerns via interagency coordinating groups like the Technology Transfer Working Group and the Missile Technology Export Control committee.

Question for the Record Submitted to
Deputy Assistant Secretary of State Thomas E. McNamara
by Senator David Pryor
Committee on Government Affairs
June 15, 1994

Question:

4. Because DTC was not reading the sales reports on manufacturing agreements, you are now going to a system of self-reporting. How many audits will you perform on an annual basis to ensure that these reports are accurate? Who will perform these audits?

Answer:

DTC is exploring a system of self-reporting by applicants to verify receipt of annual sales reports required for approved agreements. The applicant to the agreement would be required to certify to DTC annually by letter that it has received a sales report from the foreign party and that sales have been made only to authorized countries and end-users. DTC staff would audit the receipt of the responses. In addition, individual companies would be selected to provide copies of the annual reports for DTC personnel to inspect. Finally, DTC could conduct quarterly on-site inspections of randomly selected companies. Should a system of on-site inspections be implemented, DTC anticipates sending personnel to company facilities for inspections of their recordkeeping and export licensing and compliance procedures and policies.

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for Export Administration
Washington, D.C. 20230

July 18, 1994

The Honorable David Pryor
Chairman, Subcommittee on Federal Services
Committee on Governmental Operations
United States Senate
Washington, D.C. 20510-6250

Dear Senator Pryor:

As you requested in your letter of June 17, 1994, I am transmitting my answers to your questions following up my testimony on June 15. I have also enclosed answers to separate questions submitted by Senator Cochran. I will be pleased to answer any further questions you might have.

Sincerely,

William A. Reinsch

Responses to Questions for Under Secretary Reinsch from Senator Pryor

1) Q: Were you aware of these gaps in your watchlist?

A: Although our established procedures have identified more than 33,000 names for inclusion on the watchlist, we learned from the General Accounting Office (GAO) study that we were making less than full use of two sources of names. These sources are the Department of Justice listings of significant export control cases and names from the Department of State's Office of Defense Trade Controls watchlist which are relevant to dual use controls. We are obtaining this information now and we will incorporate the names into our watchlist.

2) Q: Will you conduct an investigation of the cases cited by GAO to determine what harm may have occurred to U.S. national security?

A: BXA requested the license numbers of these cases from GAO when it first reported its findings to us. As of July 13, they have not provided them. When we receive the data, we will examine it to determine if any harm to U.S. national security occurred.

3) Q: Does it concern you that Commerce approved 49 licenses despite negative intelligence information on the person or company applying for a license?

I assume this question refers to page 8 of GAO's report, where GAO states that "Commerce approved 49 licenses after its pre-license checks failed to corroborate the negative intelligence information involving the parties on the applications." I cannot speak specifically about these 49 licenses because GAO has not yet identified them for our review.

The committee should keep in mind, however, that intelligence information is only one of the tools used in determining the national security or proliferation risk of a proposed export. We may decide, after thorough interagency consultation, that an export does not make a material contribution to any activities of concern and is entirely appropriate for the stated end use, a known benign activity of the same consignee. For example, in years past, we might have formally considered the export of a low level computer to handle personnel records or payroll, even if the recipient was a questionable end user. (Such computers have subsequently been largely decontrolled.) As I testified at the hearing, the presence of a name on our watchlist is generally not, in itself, grounds for denial.

4) Q: Will you conduct an investigation of these cases and analyze what harm may have been done to U.S. national security? For both this answer, and the answer to question 2, please provide me with an unclassified version of your review.

A: As noted in our answer to Question 2, we will be able to review these cases as soon as the GAO identifies them. I will send you an unclassified version of the review when it is completed.

Response to Additional Questions for Under Secretary Reinsch from Senator Cochran

1) Q: Please explain how the various watchlists are formulated. How often are they updated? On what grounds? Are the lists disseminated to departments and agencies that are part of the process each time they're updated?

A: Commerce's watchlist is a computerized database that contains more than 33,000 names. Commerce special agents or analysts add names to the watchlist when they need to review validated export license applications involving those parties. They remove names from the watchlist if they no longer need to conduct such reviews. Changes to the watchlist are made whenever the need arises. Since the "list" is really a computerized database it is updated almost instantaneously throughout the day. The reasons for placing a name on our watchlist include such things as: information that a party may be involved in attempted illegal exports; that it may support terrorist activities; that its products are sought by countries or end users to whom they would be denied; or the party itself is denied export privileges.

We do not transmit the entire watchlist to all agencies involved in the export license decision making process each time it is updated. To do so would serve no useful purpose. All applications are screened against the watchlist. We use information from other agencies when deciding to place names on the watchlist. However, we do compile a list of the entities, derived from our watchlist, that represent the greatest export control concerns. We distribute this list annually to all executive branch agencies involved in export control issues. We also send it to all U.S. diplomatic posts for their use in export control matters. This publication includes approximately 7000 names.

2) Q: There are clearly problems with export control coordination within the executive branch.

- o How would each of you propose to remedy these problems?
- o Do you believe there should be one central watchlist within the executive branch?
- o Is legislation necessary to address this problem?

I understand the coordination problems to which you refer come from the General Accounting Office's (GAO) recommendation that Commerce and State coordinate more on exchange of watchlists.

As I testified, in response to GAO's recommendations, we have agreed to both make available to State all portions of our

watchlist they deem relevant to their license reviews and to review their watchlist with the same intent. BXA has taken the following actions to fulfill that commitment.

- We have met with the Office of Defense Trade Controls (DTC) at the State Department and reviewed their watchlist in detail, and they have reviewed ours.

- We are exploring the feasibility of electronic exchange of relevant watchlist information between State and Commerce.

- Before the end of July, we intend to contact all diplomatic posts requesting that they send copies of their unfavorable pre-license check and post-shipment verification responses to both DTC and Commerce.

We have also agreed to provide feedback to the original source agency when our pre-license check information is at variance with their information.

There are sufficient variations in the lists and the missions of the two agencies that separate lists are desirable. For example, DTC's list contains names of parties debarred from government contracts by the General Services Administration and parties whose DTC registrations have expired. Neither of these facts is, by itself, relevant to a licensing decision regarding Commerce controlled items.

I believe the Administration's proposed Export Administration Act is the only legislation we require to continue the improvements we have undertaken to make our licensing decisions more accurate, consistent and timely.

3) Q: What role does the CIA's Nonproliferation Center have in the export license approval process? Does the CIA have its own separate and distinct watchlist?

The Nonproliferation Center (NPC) does not recommend approval or denial of license applications. It provides the raw intelligence data that helps the technical experts in the reviewing agencies determine the national security or proliferation risks in a particular transfer of commodities or technology. It is important to note that in addition to getting direct referral of cases for all countries of concern, NPC is represented on the interagency groups dealing with cases that are controlled for nuclear, missile technology and chemical and biological weapons reasons. It provides intelligence information and briefings in these meetings at a higher level of classification than is readily accessible to our licensing staff. We are also moving toward 100% case referral to the NPC.

I understand that the CIA does not have a watchlist in the sense of retaining a list of names against which all export license applications are screened. The CIA furnishes the Department of Commerce with information. BXA then determines whether the information merits placing a name on its watchlist.

4) Q: What role does the Defense Department have in the review of export license applications on dual-use items that aren't part of our Foreign Military Sales Program and don't go through the Pentagon's Defense Security Assistance Administration?

The Department of Defense, Defense Technology Security Administration (DTSA), reviews all Commerce licenses for a selected group of countries of concern. It is also represented on the interagency groups that evaluate applications of proliferation concern. This gives DTSA access to **all** cases that are reviewed for missile technology and chemical/biological weapons concerns, as well as the more sensitive cases reviewed for nuclear concerns. They also participate in the interagency groups that review export applications that are escalated because they were not resolved at the working level.

In addition, when the new Export Administration Act is approved and goes into effect, all agencies involved in dual use licensing will be able to review any applications they choose to see.

The Washington Post

AN INDEPENDENT NEWSPAPER

Rwanda's Arms Suppliers

THE DEATH TOLL in Rwanda would have been horrendous enough if weaponry had been limited to local arms of choice—machetes and clubs. But imports of small arms, machine guns, mortars, artillery pieces and military vehicles have helped push the estimated toll toward a half-million and counting. A month ago the Security Council, to interdict resupply, pronounced a general arms embargo. But the United Nations commander on the ground now says: "The horror show continues. Both sides still have resources and a capability to fight on."

A new phase in the old business of arms sales has come into being with the post-Cold War proliferation of ethnic and tribal conflicts within countries. The resulting arms demand has tempted suppliers around an ostensibly more peaceful world to keep their defense industries running and profitable. Sooner or later, you would think, poorer buyers run up against their credit limits. But what is for a big country a trivial budget of a few million dollars can keep a small country flush with weapons.

This is how the killer Hutu government of Rwanda has received arms or advice from its longtime military patron France, from Egypt, whose rocket launchers are currently pounding Kigali, and from the old South Africa. The new South Africa's president, Nelson Mandela, sees "nothing wrong" with selling arms for defense and promises that his country's exports won't get into the "wrong hands."

"Merchants of death" are an easy target, and sometimes a fair one. Arms sales to rogue states, ones that flout the international rules, must be aggressively limited, and some countries are just plain overarmed. But otherwise the target has to be narrowed. Measured selling to states whose sovereignty and security are at risk from across a border needs to be distinguished from profligate selling to rogue states or vengeful elements creating bloody disorder and mass death. Arms sales ought to be registered in a public place, national or international, to permit outside review.

The United States is a secure and powerful state with a long record of exporting arms to dubious governments and into conflict-prone regions for reasons of its own. It is poorly placed to preach a gospel of restraint. But as a leading global actor, the United States is well placed to demonstrate some restraint: to deny and police sales to the rogue states, to reward with more aid countries that reduce military spending, to extend transparency and to support the linkage of arms sales to the resolution of the disputes they sometimes feed.

WATCHLIST SYSTEM FLAWED

Commerce

Company identified by Commerce in October 1991 as a violator of export controls	Company received 15 licenses between December '91 & June '92
Person identified by Commerce on June 23, 1992 as a concern for missile technology reasons	Party's license approved July 8, 1992
Company identified by Commerce in November 1991 as an apartheid supporting party	Company received 3 licenses between April '92 & May '93

State

Company convicted in March 1992 of violating AECA AECA for exporting avionics equipment to Iran. Company also debarred by State & subject to a Commerce export Denial Order	Company received 3 licenses between July and December 1992
Company identified by State in June 1991 as a concern for missile technology reasons	Company received 3 licenses between April '92 and April '93
Company identified by State in April 1992 as a concern based on information from the Admin Office of the Courts	Company received 4 licenses between October '92 and May '93

NAMES MISSING FROM WATCHLIST

Commerce

According to intelligence information, company was involved on 1-19-93 in purchasing helicopter avionics equipment for China	Company's license approved on 2-2-93

State

A Blue Lantern check in February 1992 found that the company was selling F-16 parts without authorization	Company's license approved in May 1993
According to intelligence information, company was involved in diverting aircraft parts to Iran in March 1993	Company received 44 licenses between April 1993 and July 1993
Commerce information in December 1991 identified the company as the subject of an unfavorable license check	Company's license approved in September 1992

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